Supreme Court, U. S.
FILED
JAN 23 1979
MICHAEL RODAK, JR., CLERK

APPENDIX

In the Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-309

TOUCHE ROSS & CO.,

Petitioner,

— *v.* —

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED AUGUST 23, 1978
CERTIORARI GRANTED NOVEMBER 27, 1978

INDEX

	Page
Relevant Docket Entries	1
Complaint, Filed April 30, 1976, Served May 12, 1976	5
Exhibit A to Complaint: Weis, Voisin & Co., Inc., Report on Examination of Statement of Financial Condition, May 26, 1972	35
Exhibit B to Complaint: Weis, Voisin & Co., Inc., Answers to Financial Questionnaire and Additional Information, May 26, 1972	42
Exhibit C to Complaint: Weis, Voisin & Co., Inc. and Subsidiaries, Report on Examination of Consolidated Financial Statements, Year (52 Weeks) Ended May 26, 1972	67
Exhibit D to Complaint: Weis, Voisin & Co., Inc. and Subsidiaries, Report on Examination of Consolidated Financial Statements, Five Years Ended May 26, 1972	85
Defendant's Notice of Motion to Dismiss, Filed September 22, 1976	112
Affidavit of Arnold I. Roth in Support of Motion to Dismiss, Filed September 22, 1976	114
Exhibit 1 to Affidavit of Arnold I. Roth: Complaint in this Action, Filed April 30, 1976, Served May 12, 1976	120
Exhibit 2 to Affidavit of Arnold I. Roth: Summons in the State Court Action, pending in the Supreme Court of the State of New York, County of New York, Served July 3, 1975	121
Exhibit 3 to Affidavit of Arnold I. Roth: Complaint in the State Court Action, pending in the Supreme Court of the State of New York, County of New York, Served May 3, 1976	123

Page

Affidavit of Wilfred R. Caron in Opposition to Motion to Dismiss, Filed January 10, 1977 146

Affidavit of Clarence Fried in Opposition to Motion to Dismiss, Filed January 10, 1977 151

Affidavit of Bruce E. Baker in Opposition to Motion to Dismiss, Filed January 10, 1977 156

Exhibit A to Affidavit of Bruce E. Baker: Proof of Claim dated July 11, 1973 158

Exhibit B to Affidavit of Bruce E. Baker: Proof of Claim dated July 11, 1973 161

Reply Affidavit of Arnold I. Roth in Support of Motion to Dismiss, Filed February 7, 1977 164

Opinion of the United States District Court for the Southern District of New York, Filed March 1, 1977 169

Order and Judgment of the United States District Court for the Southern District of New York, Filed March 15, 1977 188

Opinion of the United States Court of Appeals for the Second Circuit, Filed April 21, 1978 190

Judgment of the United States Court of Appeals for the Second Circuit, Filed April 21, 1978 225

Order of the United States Court of Appeals for the Second Circuit Denying Petition for Rehearing, Filed July 7, 1978 227

Order of the United States Court of Appeals for the Second Circuit Denying Rehearing En Banc, Filed July 7, 1978 228

Relevant Docket Entries

UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

DATE 1976	PROCEEDINGS
4-30	Filed complaint. Issued summons.
5-20	Filed summons with marshals return. SERVED: TOUCHE ROSS & CO. on 5-12-76.
6-07	Filed stp & order that the time of deft to answer etc, is extended to 6-23-76, Wyatt, J.
6-09	Filed Notice that pltff will take deposition of Karl Brunhuber on 6-21-76 as indicated.
7-12	Filed Stip & Order that the time for dft. to answer complaint is extended to 7-13-76. . . . Ward J.
7-21	Filed Notice of Appearance of Rosenman Colin Freund Lewis & Cohen. as indicated.
7-23	Filed pltffs first set of interrogatories.
7-27	Filed stip & order that the time for deft to move etc, is extended to 9-15-76, etc, as indicated. Conner J.
8-24	Filed defts objections and answers to interrogatories to pltff.
9-07	Filed pltffs Affidavit & Notice of motion for an order striking defts blanket objections to pltffs, first set of interrogatories, etc, as indicated rtble before Mag. Schreiber on 9-21-76.
9-07	Filed pltffs memorandum of law as indicated.
9-22	Filed defts Affidavit & Notice of Motion for an order dismissing this action etc, as indicated rtble on 10-1-76.
9-22	Filed memorandum of deft Touche Ross & Co. in support of motion to dismiss, etc, as indicated.
9-23	Filed stip & order that the deposition of Karl Brunhuber is adjourned to 10-20-76, and pltffs motion is adjourned to a mutually convenient date to be determined after consultation with Mag. Schreiber. Wyatt, J.
9-30	Filed defts Affidavit in opposition to the motion of the pltffs etc, as indicated.
9-30	Filed defts memorandum in opposition to pltffs motion to compel further discovery.

DATE [1976]	PROCEEDINGS
11-15	Filed stip & order that pltffs shall have to 1-7-77 to serve papers with respect to defts motion of 9-15-76 to dismiss or stay this action etc, as indicated, Wyatt, J.
1977	
1-10	Filed affidavit in opposition to motion to dismiss.
1-10	Filed pltffs memo in opposition to motion to dismiss.
1-10	Filed memorandum of pltff's Securities Investor Protection Corp. in opposition to deft's motion to dismiss.
1-10	Filed pltff's Securities Investor Protection Corp. affdvt. in opposition to deft's motion to dismiss complaint.
2-07	Filed defts. reply affdvt. to dismiss the complaint and for related relief.
2-07	Filed defts. reply memorandum of deft. Touche Ross & Co., in support of motion to dismiss and for related relief.
2-14	Filed Pltffs. Redington, sur-reply memorandum of law.
3-01	Filed Opinion #45650 There can be no jurisdiction simply because SIPC was created by Act. of congress because there is no stock ownership in SIPC by the United States. Finally, the Trustee is a citizen of New York and is a pltff. along with SIPC. Partners of Touche, the deft. are citizens of N.Y. Thus, there is no complete diversity of citizenship within the rule of Strawbridge v. Curtiss, 3 Cranch 267 (1806). The fifth, sixth, seventh, and eight[h] claims of SIPC must be dismissed for lack of jurisdiction over the subject matter . . . . . So Ordered . . . WYATT, J. Settle order and judgment on notice. m/n
3-15	Filed Order & Judgment this action is dismissed, and deft. have judgment against pltffs, and each of them, dismissing this action . . . So Ordered . . . . . WYATT, J. Judgment Ent. on 3-15-77 . . . m/n

DATE [1977]	PROCEEDINGS
4-13	Filed Pltffs. Edward S. Redington, notice of appeal to the U.S.C.A. from the order & Judgment Ent. in this action on the 15th day of March 1977 . . Mailed All Copies.
4-14	Filed Pltffs. Securities Investor Protection Corp. notice of appeal to the U.S.C.A. from the order & Judgment Ent. in this action on the 15th day of March 1977 . . . Mailed all copies.
5-13	Filed stipulation designating a copy of an originally filed document to become part of the record on appeal.

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

DATE	FILINGS—PROCEEDINGS
4-14-77	Filed copies of docket entries and notice of appeal (Edward S. Redington)
4-14-77	Filed copies of docket entries and notice of appeal (Securities Investor Protection Corporation)
5-13-77	Filed record (original papers of district court)
7-12-77	Filed briefs, appellant, p/s (Redington)
7-12-77	Filed briefs, appellant, p/s (SIPC)
7-12-77	Filed joint appendix, appellants, p/s
8-22-77	Filed motion for leave to file brief amicus curiae, p/s (S.E.C.) (& in 77-7186)
8-25-77	Received stipulation consenting to the filing of the S.E.C. amicus brief and for a modified scheduling order, appellee, p/s (& in 77-7186)
8-31-77	Filed order granting motion for leave to file a brief as amicus curiae on consent. Further ordered that appellees shall file a brief by 9-23-77, reply brief, if any, by 10-25-77, appeal ready to be heard during the week of 11-7-77. Appellees shall deliver to appellants copy of galley or page proof of its brief by 9-20-77
8-31-77	Filed brief, amicus curiae, p/s (SEC)
9-28-77	Filed printed briefs, appellee, p/s

DATE	FILINGS—PROCEEDINGS
10-25-77	Filed reply briefs, appellant, p/s (& in 77-7186)
10-25-77	Filed reply brief, appellant, p/s (Sec. Investor etc.) (& in 77-7186)
11-14-77	Argument heard (By: Lumbard, Mulligan, Timbers, CJJ) (& in 77-7186)
4-21-78	Judgment reversed as to both plaintiffs and remanded-Lumbard, C.J.
4-21-78	Concurring in separate opinion—Timbers, C.J.
4-21-78	Dissenting in separate opinion—Mulligan, C.J.
4-21-78	Filed judgment
5-5-78	Filed petition for rehearing and rehearing en banc, appellee, pfs
7-7-78	Filed order denying petition for rehearing
7-7-78	Filed order denying petition for rehearing en banc
7-13-78	Filed motion for leave to stay issuance of mandate, appellee, pfs
7-17-78	Filed memorandum in opposition to motion for leave to stay mandate, appellant, pfs
7-21-78	Filed reply to memorandum in opposition to motion for leave to stay mandate, appellee, pfs
7-24-78	Filed order granting motion for leave to stay issuance of mandate
8-23-78	Filed notice of filing petition for writ of certiorari (S.C. #78-309)
9-25-78	Filed notice of filing petition for writ of certiorari (Redington) S.C. #78-493
9-29-78	Filed notice of filing petition for writ of certiorari (Securities Investor Protection Corp.), S.C. #78-526
12-4-78	Filed certified copy of order granting petition for writ of certiorari (S.C. #78-309)

Complaint

Filed April 30, 1976, Served May 12, 1976

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Plaintiffs,

—against—

TOUCHE ROSS & CO.,

Defendant.

76 Civ. 1981 (IBW)

COMPLAINT

PLAINTIFFS DEMAND A TRIAL BY JURY

Plaintiffs EDWARD S. REDINGTON, Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION, by their respective attorneys, complaining of the Defendant, allege as follows:

JURISDICTION AND VENUE

1. This action arises under the Securities Exchange Act of 1934 (15 U.S.C. Sections 78a *et seq.*) (hereinafter the "1934 Act") and particularly under Section 17 thereof (15 U.S.C. Section 78q), the Securities Investor Protection Act of 1970 (15 U.S.C. Section 78aaa *et seq.*) (hereinafter the "1970 Act"), and the common law.

2. This Court has jurisdiction over Plaintiff Redington's claims by virtue of Section 27 of the 1934 Act (15 U.S.C. Section 78aa); Section 6 of the 1970 Act (15 U.S.C. Section 78fff); Sections 2a(7), 102 and 115 of the Bankruptcy Act (11 U.S.C. Sections 11a(7), 502 and 515); Sections 1331 and 1334 of the United States Judicial Code (28 U.S.C. Sections 1331 and 1334); and principles of pendent jurisdiction. The amount in controversy, exclusive of interest and costs, exceeds the sum of $10,000.

3. This Court has jurisdiction over the claims of Plaintiff Securities Investor Protection Corporation by virtue of Section 27 of the 1934 Act (15 U.S.C. Section 78aa), Sections 1331 and 1332 of the United States Judicial Code (28 U.S.C. Sections 1331 and 1332), and principles of pendent jurisdiction. The amount in controversy, exclusive of interest and costs, exceeds the sum of $10,000.

4. Defendant has its principal place of business in this District and most of the acts alleged herein occurred in this District.

PARTIES

5. Plaintiff Edward S. Redington (hereinafter the "Trustee"), pursuant to the 1970 Act, was duly appointed by Order of this Court dated May 30, 1973 as Trustee for the liquidation of the business of Weis Securities, Inc. ("Weis"), has duly qualified, and is presently acting in such capacity. Section 6(b)(1) of the 1970 Act (15 U.S.C. Section 78fff(b)(1)) provides that a trustee appointed under the 1970 Act shall be vested, *inter alia*, with the same powers and title with respect to the debtor and the property of the debtor as a trustee in bankruptcy and a trustee under Chapter X of the Bankruptcy Act (11 U.S.C. Sections 501-676) have with respect to a bankrupt and a Chapter X debtor.

6. Plaintiff Securities Investor Protection Corporation (hereinafter "SIPC") is a non-profit membership corporation created by and organized under the 1970 Act whose members are, with certain statutory exceptions, all persons registered as broker-dealers under Section 15(b) of the 1934 Act (15 U.S.C. Section 78o(b)) and, with certain statutory exceptions, all persons who are members of a national securities exchange. SIPC has its principal place of business in the District of Columbia. At all relevant times Weis was a member of SIPC.

7. Defendant Touche Ross & Co. ("Touche Ross") is a partnership of certified public accountants with its principal place of business at 1633 Broadway in the City, County and State of New York. In or about 1969 Touche Ross was engaged by Weis as its independent certified public accounting firm, and Touche Ross continued to act in such capacity from about 1969 until about May 1973, when the forced liquidation of Weis commenced.

COMMON ALLEGATIONS

8. At all relevant times prior to May 30, 1973, Weis was a corporation registered as a broker-dealer with the Securities and Exchange Commission (the "SEC") and was engaged in the business of a broker-dealer in securities. From June 1965 until May 1973, Weis was a member of the New York Stock Exchange, Inc. (the "Exchange"), the self-regulatory organization designated by SIPC to examine Weis for compliance with the applicable financial responsibility rules which are imposed on broker-dealers pursuant to Section 6 of the 1934 Act (15 U.S.C. Section 78f) for the protection of the public as a minimum prerequisite for conducting a securities brokerage business.

9. For each of its four fiscal years 1968 through 1971 (ended May 31), Weis' audited financial statements reflected a profit. During early 1972 five of Weis' officers

(the "Weis Five") became increasingly concerned that a fair and accurate presentation of Weis' results of operations for fiscal year 1972 would reflect that Weis was operating at a loss.

10. The Weis Five misstated the financial condition and results of operations of Weis in financial reports prepared at fiscal year-end 1972. These reports were required to be filed with regulatory authorities pursuant to Section 17 of the 1934 Act (15 U.S.C. Section 78q) and were directly or indirectly submitted to Weis, its Board of Directors, the SEC, SIPC, the Exchange, and Weis' customers, creditors, lenders and shareholders. Such misstatements were accomplished, by *inter alia,* materially overstating assets, creating non-existent assets, understating liabilities, overstating income, and understating expenses. The purpose and effect of such material misstatements were, *inter alia,* to create a false impression that Weis' earnings for the fiscal year ended May 26, 1972 were $1,700,000 before taxes whereas in truth and in fact Weis had actually suffered losses in that period in excess of $1,500,000.

11. Had Weis' actual financial condition, its actual results of operations, and the misstatements in its books and records been truthfully reported at the end of Weis' 1972 fiscal year, Weis' 1973 forced liquidation under the 1970 Act would not have become necessary, and most if not all of Weis' assets and its good will as a going concern could have been preserved by a number of means including, *inter alia,* change in Weis' management, reversal of its policy of growth and expansion, curtailment or contraction of certain of its operations and business practices, gradual liquidation of some or all of its operations, or merger with another securities firm. Moreover, if a liquidation of Weis had been necessary as the result of such truthful reporting, such liquidation could have

occurred at the end of Weis' 1972 fiscal year, when its assets were greater and the aggregate of its liabilities was lower than a year later.

12. The incorrect and incomplete fiscal 1972 year-end reports prepared by or under the direction of the Weis Five were certified by Touche Ross as being correct and complete. Consequently, the doctoring of Weis' books, records and required reports, the deterioration of its financial condition and the violations of financial responsibility rules could not be nipped in the bud at a time when a forced liquidation of Weis could still have been avoided. Instead, during Weis' fiscal year 1973, Weis' financial condition deteriorated further as the Weis policy of expansion continued unabated. Weis incurred substantial operating losses, depletion of its assets, and depletion of the property held by Weis in trust for its customers. The Weis Five continued to make false and fictitious entries in Weis' books and records, and continued directly or indirectly to submit false reports to Weis, its Board of Directors, the SEC, SIPC, the Exchange, and Weis' customers, creditors, lenders and shareholders in order to conceal Weis' true financial condition.

13. Not until April and May of 1973, as a result of separate investigations by the Exchange and the SEC, did the misstatement of Weis' financial condition come to light. These investigations gradually revealed violations of financial responsibility rules, Weis' unsafe, unsatisfactory and deteriorating financial condition, and the lack of accuracy and reliability of any of its financial statements, including those certified by Touche Ross. These revelations and the resulting uncertainties with respect to Weis' true financial condition prevented Weis from being saved as a going concern or being merged with another, financially more secure, brokerage firm, and resulted in Weis' forced liquidation under the 1970 Act.

14. On May 24, 1973, the SEC commenced an action in this Court (73 Civ. 2332) against Weis and the Weis Five for injunctive relief to prevent them from conducting the business of Weis in violation of the 1934 Act and the rules and regulations promulgated thereunder. Also on May 24, 1973 (the "Filing Date"), pursuant to Section 5(a)(2) of the 1970 Act (15 U.S.C. Section 78eee (a)(2)), SIPC applied in this Court for a decree adjudicating that the customers of Weis were in need of the protection of the 1970 Act. On May 30, 1973 (the "Date of Adjudication") such a decree was granted, the liquidation of Weis was ordered, and Plaintiff Edward S. Redington was appointed Trustee for the liquidation of the business of Weis.

15. Upon the entry of the decree referred to in the preceding paragraph, SIPC was required by the 1970 Act to provide, and did provide to the Trustee, funds for the payment of claims submitted by customers and certain other creditors of Weis and for certain administrative expenses of the liquidation.

16. At all relevant times, Defendant Touche Ross held itself out to Weis, the SEC, SIPC, the Exchange and the general public as possessing the ordinary skill, ability and expertise of certified public accountants in accounting and auditing matters, and as being qualified, *inter alia,* (i) to examine and audit the books, records and accounts of firms engaged in the securities business in accordance with generally accepted auditing standards, (ii) to express opinions with respect to the financial statements of such firms as fairly reflecting their financial condition and results of operations in accordance with generally accepted accounting principles, and (iii) to prepare and assist in the preparation of the reports concerning such books, records, accounts and opinions required by Section 17 of the 1934 Act (15 U.S.C. Section 78q) and the rules and regulations promulgated thereunder. Touche Ross further

held itself out as being familiar with accounting and auditing practices and standards required by the SEC and the Exchange for firms engaged in the securities business.

17. From approximately 1969 until the Date of Adjudication, Touche Ross was engaged by Weis for valuable consideration to serve as Weis' independent certified public accounting firm. During this period Touche Ross agreed to conduct annual audits of the affairs of Weis and to issue opinions and prepare reports on its financial statements, all in accordance with Section 17 of the 1934 Act (15 U.S.C. Section 78q), generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the SEC and the Exchange. In accepting said engagement, Touche Ross agreed to perform said services in a thorough, proper, skillful and diligent manner.

18. Weis and its Board of Directors, customers, creditors, lenders and shareholders, and the SEC, the Exchange and SIPC relied on Touche Ross to apply the standards and expertise, to express the opinions, to make the certifications and to prepare or assist in the preparation of the reports discussed in paragraphs 16 and 17, *supra*, for the purposes, among others, of (i) protecting Weis from fraudulent activity of its officers, directors, agents, and employees; (ii) safeguarding the existence and use of Weis' assets; (iii) assuring the accuracy of financial data submitted directly or indirectly to the Exchange, the SEC and SIPC, and generally made available to the public; (iv) determining whether Weis could continue to engage in business as a broker-dealer in securities; (v) determining whether or not significant restrictions and alterations in the scope and nature of its operations would be required in order for Weis to continue to engage in business as a broker-dealer; and (vi) making informed business decisions concerning the future operations of Weis on the basis of accurate financial information.

19. In or about late 1971 or early 1972, Touche Ross agreed with Weis to perform the aforementioned auditing and accounting services for the year 1972. Among other things, Touche Ross agreed (a) to prepare, cause to be prepared, and assist in the preparation of financial statements of Weis and to issue opinion letters with respect to said statements; (b) to audit the affairs of Weis in accordance with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations promulgated by the Exchange and the SEC pursuant to Sections 6 and 17 of the 1934 Act (15 U.S.C. Sections 78f and 78q); (c) to notify the Exchange promptly that such audit had been commenced; (d) To prepare an answer to the financial questionnaire (the "Answers to the Financial Questionnaire") of the Exchange based upon said audit; (e) to submit to the Exchange (i) a copy of the Answers to the Financial Questionnaire, (ii) an attestation that the requirements of the audit regulations had been observed in the conduct of the audit, and (iii) a statement that Touche Ross had made a review of Weis' accounting system, internal accounting control, and procedures for safeguarding securities; (f) to furnish to the Exchange comments relative to any material inadequacies found to exist in Weis' accounting system, internal accounting control, and procedures for safeguarding securities; and (g) to indicate any corrective action taken or proposed.

20. Weis' employment of Touche Ross as its independent certified public accounting firm was not merely a matter of private contract between Weis and Touche Ross, but was required by the Exchange pursuant to its duty under Section 6 of the 1934 Act (15 U.S.C. Section 78f) to regulate its members' conduct of their businesses and supervise their financial condition for the benefit of the public. Touche Ross knew or should have known that Weis' engagement of an independent certified public

accounting firm was a requirement of the Exchange and that it was for the benefit both of Weis in making decisions with respect to the operation of its business and of persons other than Weis.

21. Touche Ross' examination of and report on Weis' financial condition were not intended solely for the benefit of Weis but were, pursuant to Section 17 of the 1934 Act (15 U.S.C. Section 78q) and the rules and regulations promulgated thereunder, intended for and submitted directly or indirectly to, *inter alia*, the SEC, the Exchange, SIPC, and Weis' customers, creditors, lenders and shareholders. The Exchange was the organization designated and relied upon by SIPC to examine Weis for compliance with the applicable financial responsibility rules and to alert SIPC of Weis' financial difficulty.

22. Touche Ross knew or should have known that its examination of and report on Weis' financial condition were a requirement of Section 17 of the 1934 Act (15 U.S.C. Section 78q) and the rules and regulations promulgated thereunder, and were for the benefit both of Weis and of persons other than Weis.

23. In accordance with its engagement agreement, Touche Ross purported to conduct an audit of Weis' books and records for the fiscal year ended May 26, 1972 and in connection therewith (a) certified, prepared, caused to be prepared, and assisted in the preparation of financial statements of Weis; (b) certified and prepared Weis' Answers to the Financial Questionnaire; and (c) issued four opinion letters (the "1972 Opinion Letters") to the Board of Directors of Weis dated, respectively, July 7, 1972, July 7, 1972, July 21, 1972 and July 21, 1972.

24. By means of the foregoing, Touche Ross represented and certified that it had examined (i) the statement of Weis' financial condition as of May 26, 1972, (ii) Weis' Answers to the Financial Questionnaire as of May 26, 1972, (iii) Weis' consolidated balance sheet for the 52

weeks ended May 26, 1972, and (iv) Weis' consolidated statement of earnings for the five years ended May 26, 1972. The letter pertaining to the Answers to the Financial Questionnaire stated that the Touche Ross examination had been made "in accordance with generally accepted auditing standards, and accordingly included a review of the accounting system, internal accounting control and the procedures for safeguarding securities including such tests thereof . . . as [Touche Ross] considered necessary in the circumstances, including the audit procedures prescribed by the New York Stock Exchange and the Securities and Exchange Commission." The letter also stated that the Answers to the Financial Questionnaire presented fairly the financial position of Weis at May 26, 1972 in the form prescribed by the Exchange and the SEC in conformity with generally accepted accounting principles applied on a consistent basis. Each of the other three 1972 Opinion Letters stated that the Touche Ross examination had been conducted in accordance with generally accepted auditing standards and that the aforementioned financial statements presented fairly the financial position of Weis and subsidiaries at May 26, 1972, and the results of operations and changes in their financial position for the year and the five years then ended, in conformity with generally accepted accounting principles applied on a consistent basis. (The 1972 Opinion Letters and accompanying Answers to the Financial Questionnaire and financial statements are annexed hereto as Exhibits A, B, C and D.)

25. Touche Ross knew, should have known and intended that Weis and its Board of Directors would rely on the 1972 Opinion Letters and accompanying Answers to the Financial Questionnaire and financial statements for various purposes, including those set forth in paragraph 18, *supra*.

26. Touche Ross knew, should have known and intended that the SEC, the Exchange and SIPC would rely on the 1972 Opinion Letters and accompanying Answers

to the Financial Questionnaire and financial statements in carrying out their respective regulatory, supervisory and protective duties with respect to Weis, in determining whether Weis was in compliance with the applicable financial responsibility rules, and in determining whether Weis was in financial difficulty.

27. Touche Ross knew, should have known and intended that Weis' customers, creditors, lenders and shareholders would rely directly or indirectly on the 1972 Opinion Letters and accompanying Answers to the Financial Questionnaire and financial statements in making decisions whether to commence or continue their respective relationships with Weis.

28. Touche Ross breached and failed to perform its agreement and obligation to render auditing and accounting services with respect to Weis in a thorough, proper, skillful and diligent manner and performed said services in a negligent, reckless, careless, unskilled and grossly negligent manner in that, among other things, it:

a. failed to audit, verify and examine the books, records, accounts and financial statements of Weis in accordance with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and the SEC;

b. failed to prepare, cause to be prepared, and assist in the preparation of accurate financial statements of Weis and Weis' Answers to the Financial Questionnaire;

c. rendered the 1972 Opinion Letters, which were false, inaccurate and incomplete;

d. failed properly to test, study and evaluate Weis' system of internal accounting control;

e. failed to obtain competent evidential matter sufficient to afford a proper basis for the 1972 Opinion Letters;

f. falsely certified that it had examined Weis' books and records in accordance with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and SEC; and

g. failed to inform or otherwise alert Weis, its Board of Directors, the SEC and the Exchange (and, through the Exchange, SIPC) (i) of the material errors in Weis' Answers to the Financial Questionnaire and in Weis' financial statements prepared in connection with the 1972 Touche Ross audit; (ii) of the existence of inaccurate and unreliable books and records with respect to Weis; or (iii) of the possibility that Weis was facing financial difficulty.

29. Specifically, among other things, Touche Ross failed properly to audit, verify and examine:

(a) the Scheinman Hochstin & Trotta liquidation omnibus account (the "SH&T Omnibus Account"), a claimed asset of $745,000. If Touche Ross had audited, verified and examined the SH&T Omnibus Account in accordance with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and the SEC, it would have discovered the following:

(1) that in or about April 1972 the SH&T Omnibus Account had been debited in the amount of approximately $625,000;

(2) that, contrary to generally accepted accounting principles, the offsetting credits for this debit were to one or more income accounts;

(3) that the purpose and effect of these improper credits were to overstate Weis' gross income by approximately $625,000 and its net income and net worth by approximately $312,500; and

(4) that an overstatement by this amount was a material overstatement because it constituted over 30% of Weis' claimed net income for the entire fiscal year ended May 26, 1972 and over 4% of Weis' claimed net worth as of that date.

(b) the Winslow, Cohu & Stetson ("WC&S") insurance claim receivable, a claimed asset of $1,285,000. If Touche Ross had audited, verified and examined the WC&S insurance claim receivable in accordance with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and the SEC, it would have discovered the following:

(1) that, on or about May 8, 1972, the WC&S insurance claim receivable had improperly been increased in value (debited) from $600,000 to $785,000 because of interest purportedly payable on the claim;

(2) that, on or about May 25, 1972, the WC&S insurance claim receivable had improperly been further increased in value (debited) to $1,285,000 because of a purported increase in the value of the claim;

(3) that, contrary to generally accepted accounting principles, the offsetting credits for these two debits had been made to various income accounts;

(4) that the purpose and effect of these improper transactions were to overstate Weis' gross income by approximately $685,000 and its net income and net worth by approximately $342,500;

(5) that an overstatement by this amount was a material overstatement because it constituted nearly 35% of Weis' claimed net income for the entire fiscal

year ended May 26, 1972 and approximately 4.5% of Weis' claimed net worth as of that date.

(c) other false, fraudulent and improper entries, irregularities and accounting transactions in the books of Weis which included, *inter alia,* the following:

(1) The re-depositing into income accounts of at least $800,000 worth of checks which were purportedly drawn to pay vendors or other creditors, thus overstating Weis' net income and net worth by at least $400,000;

(2) The doubling (to approximately $432,000) of accrued commission income for May 22-26, 1972, thus overstating Weis' net income, net worth, and net capital by approximately $108,000;

(3) The improper crediting of income accounts with proceeds from a sale-leaseback transaction, thus overstating Weis' net income and net worth;

(4) The improper transfer of certain short security positions to dividend receivable accounts;

(5) The improper failure to record certain liabilities of Weis on the books of Weis;

(6) The manipulation of certain error accounts to reflect false credit balances of $100,000 to $200,000, which then were taken into income, thus overstating Weis' net income, net worth and net capital by approximately $50,000 to $100,000;

(7) The improper designation of up to $500,000 worth of miscellaneous receivables as "current" so that it was not necessary to deduct them from capital in computing Weis' net capital ratio under Exchange

Rule 325, with the result that Weis' net capital ratio was made to appear to be below 10:1 and Weis thus was not precluded by Exchange Rule 326 from expanding its business.

30. Upon the discovery by Touche Ross of any one or more of the false entries or improper accounting transactions discussed in paragraph 29 above, Touche Ross would have had an obligation to report such discoveries, *inter alia,* to Weis, its Board of Directors, the SEC and the Exchange (and, through the Exchange, SIPC); and it would have had an obligation to report such discoveries in the 1972 Opinion Letters and to refrain from issuing the 1972 Opinion Letters in the form they actually took.

31. As a direct and proximate result of Touche Ross' failure to conduct the 1972 audit of Weis in accordance with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and the SEC:

a. the acts of the Weis Five as set forth in paragraphs 10 through 13 herein were not promptly discovered, and the Weis Five were able to continue to make false and fictitious entries in Weis' books, records and financial statements in order to conceal Weis' true financial condition during its fiscal year 1973;

b. other misstatements and inaccuracies in Weis' books, records and financial statements were not discovered;

c. Weis, its Board of Directors, the Exchange, the SEC, SIPC, and Weis' customers, creditors, lenders and shareholders were misled by Touche Ross into believing or assuming that as of May 26, 1972 Weis was in sound financial condition and in compliance with applicable financial responsibility rules;

d. Weis, its Board of Directors, the Exchange, the SEC and SIPC were prevented from (i) knowing the true financial condition of Weis, (ii) performing their respective duties to safeguard the assets of Weis and the property Weis was holding in trust for its customers, (iii) taking and causing to be taken appropriate and immediate remedial action at a time when a forced liquidation of Weis under the 1970 Act could have been prevented, and (iv) taking or causing to be taken appropriate and immediate action to avoid or reduce the costs of satisfying the claims of Weis' customers;

e. the acts of the Weis Five as set forth in paragraphs 10 through 13 herein were not discovered by Weis, its Board of Directors, the SEC, SIPC or the Exchange until April and May 1973 at which time the only remedial action that could be taken was the forced liquidation of Weis under the 1970 Act, which caused and continues to cause substantial injury to Weis and SIPC as well as Weis' customers, creditors, lenders and shareholders;

f. the assets of Weis and the property Weis was holding in trust for its customers were not on the Filing Date or thereafter sufficient to satisfy the claims of Weis' customers, creditors, lenders and shareholders;

g. Weis was unable to comply with the minimum financial responsibility rules which would allow it to conduct its business as a broker-dealer in securities, was unable to restore itself to a condition in which it could remain in business, and lost the value of its business and assets as a going concern;

h. the assets of Weis were wasted and mismanaged; and

i. Weis was caused to undertake financial obligations which it could not satisfy and which it would not or could not have undertaken had its true financial condition as of May 26, 1972 been known to Weis and its Board of Directors, the SEC, the Exchange and SIPC.

As And For Plaintiff Trustee's First Cause Of Action

32. Plaintiff Trustee repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

33. As a result of the errors and omissions of Touche Ross, including those set forth in paragraphs 28 through 30 herein, Touche Ross violated, and aided and abetted the Weis Five in violating, Section 17 of the 1934 Act (15 U.S.C. Section 78q) and the rules and regulations promulgated thereunder, which require broker-dealers such as Weis to file with regulatory authorities accurate and truthful reports of their financial condition, including reports such as those certified by Touche Ross, in order to ensure the integrity and safety of the nation's securities markets and of the brokers and dealers that participate therein.

34. Weis, its Board of Directors, its creditors, customers, lenders and shareholders were among the class of persons which Section 17 of the 1934 Act was designed to protect and were among the beneficiaries of duties imposed on Touche Ross by Section 17 of the 1934 Act. The injuries which have occurred to Weis, its creditors, customers, lenders and shareholders as a result of the liquidation of Weis were of the type that Section 17 of the 1934 Act was intended to prevent.

35. As a result of Touche Ross' violation of Section 17 of the 1934 Act and the rules and regulations promulgated thereunder, its aiding and abetting of the Weis

Five's violation of Section 17 of the 1934 Act and the rules and regulations promulgated thereunder, and its breach of the duties imposed by Section 17 of the 1934 Act and the rules and regulations promulgated thereunder, Weis, its creditors, customers, lenders and shareholders have suffered and will continue to suffer damages in an amount which is presently estimated to be at least $51,000,000.

As And For Plaintiff Trustee's Second Cause Of Action

36. Plaintiff Trustee repeats and realleges each and every allegation contained in paragraphs 1 through 34 herein as though here set forth in full.

37. As a result of Touche Ross' negligence per se in violating Section 17 of the 1934 Act (15 U.S.C. Section 78q), and not as the result of any negligence of the Trustee or Weis, Weis has suffered and will continue to suffer damages in an amount which is presently estimated to be at least $51,000,000.

As And For Plaintiff Trustee's Third Cause Of Action

38. Plaintiff Trustee repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

39. As a result of the negligence and malpractice of Touche Ross, including that set forth in paragraphs 28 through 30 herein, and not as the result of any negligence of the Trustee or Weis, Weis has suffered and will continue to suffer damages in an amount which is presently estimated to be at least $51,000,000.

As And For Plaintiff Trustee's Fourth Cause Of Action

40. Plaintiff Trustee repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

41. The auditing and accounting services performed by Touche Ross with respect to Weis were performed in so reckless and grossly negligent a manner that Touche Ross knew or should have known that the 1972 Opinion Letters and the accompanying Answers to the Financial Questionnaire and financial statements were false, inaccurate and incomplete.

42. By reason of the foregoing reckless and grossly negligent conduct of Touche Ross, and not as the result of any negligence of the Trustee or Weis, Weis has suffered and will continue to suffer damages in an amount which is presently estimated to be at least $51,000,000.

As And For Plaintiff Trustee's Fifth Cause Of Action

43. Plaintiff Trustee repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

44. In connection with the auditing and accounting services performed by Touche Ross and as compensation therefor, Weis paid Touche Ross a certain sum of money (the "Touche Ross Fee"), the amount of which is not presently known to Plaintiff Trustee.

45. By reason of Touche Ross' breach of and failure to perform its agreement to render said auditing and accounting services in a thorough, proper, skillful and diligent manner, Weis is entitled to general damages in the amount of the Touche Ross Fee and to consequential damages in an amount which is presently estimated to be at least $51,000,000.

As And For Plaintiff Trustee's Sixth Cause Of Action

46. Plaintiff Trustee repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

47. In its engagement letter with Weis and other communications to Weis, Touche Ross expressly and impliedly warranted to Weis that its services to Weis would be of a certain quality (i.e. that, *inter alia*, they would comply with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and the SEC).

48. By reason of the breaches and failures of Touche Ross, including those set forth in paragraphs 28 through 30 herein, those services were not of the warranted quality and were wholly without value to Weis.

49. By reason of Touche Ross' breach of warranty of the quality of its services to Weis, Weis is entitled to general damages in the amount of the difference between the actual and warranted values of the services rendered, and to consequential damages in an amount which is presently estimated to be at least $51,000,000.

As And For Plaintiff SIPC's First Cause Of Action

50. Plaintiff SIPC repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

51. Touche Ross' audit of Weis failed to comply with the auditing standards and regulations prescribed by the 1934 Act and the rules and regulations promulgated thereunder, in that the 1972 Opinion Letters and the accompanying Answers to the Financial Questionnaire and financial statements prepared by Touche Ross were false, inaccurate and incomplete.

52. As a consequence of the liquidation of Weis, the SIPC fund has been or may be depleted in order to satisfy the claims of over 34,000 customers and certain other creditors of Weis and to pay for certain administrative expenses of the liquidation.

53. As a result of Touche Ross' failure to comply with the auditing standards prescribed by the 1934 Act and the rules and regulations promulgated thereunder, and as a result of Touche Ross' breach of the duties it owed to SIPC thereunder, SIPC has suffered and will continue to suffer damages in an amount which is presently estimated to be at least $14,000,000.

As And For Plaintiff SIPC's Second Cause Of Action

54. Plaintiff SIPC repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

55. As a result of Touche Ross' failure to comply with the auditing standards prescribed by the 1934 Act and the rules and regulations promulgated thereunder, in that the 1972 Opinion Letters and accompanying Answers to the Financial Questionnaire and financial statements prepared by Touche Ross were false, inaccurate and incomplete, Touche Ross breached the duties it owed to the customers and certain other creditors of Weis by misleading them into believing or assuming that Weis was not in financial difficulty, and consequently over 34,000 of said customers and creditors ultimately filed claims in the Weis liquidation proceeding.

56. The SIPC fund has been or may be depleted in order to satisfy the claims of the over 34,000 customers and certain other creditors of Weis, hereinabove mentioned in paragraph 55, and to pay for certain administrative expenses of the liquidation.

57. But for Touche Ross' breach of the duties it owed to the customers and certain other creditors of Weis by its failure to comply with the auditing standards and regulations prescribed by the 1934 Act and the rules and regulations promulgated thereunder, the SIPC fund would not have been depleted to the extent that it has been, if at all, and consequently SIPC is subrogated to those claims which such customers and certain other creditors of Weis who have been paid out of the SIPC fund could have asserted against Touche Ross based on the auditing and accounting services performed by Touche Ross with respect to Weis.

58. The aggregate of the claims of Weis' customers and certain other creditors which have been satisfied out of the SIPC fund and for which Touche Ross is liable to SIPC is presently estimated to be at least $14,000,000.

As And For Plaintiff SIPC's Third Cause Of Action

59. Plaintiff SIPC repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

60. Touche Ross had knowledge of or, but for its errors and omissions, should have had knowledge of the deception caused by the Weis Five, in violation of the 1934 Act and the rules and regulations promulgated thereunder, by means of the filing or dissemination of the 1972 Opinion Letters and accompanying Answers to the Financial Questionnaire and financial statements.

61. Touche Ross breached the duties it owed to SIPC by failing to inquire as to, and to disclose, the deception caused by the Weis Five, in violation of the 1934 Act and the rules and regulations promulgated thereunder, by means of the filing or dissemination of the 1972 Opinion Letters and the accompanying Answers to the Financial Questionnaire and financial statements.

62. The SIPC fund has been or may be depleted in order to satisfy the claims of over 34,000 customers and certain other creditors of Weis and to pay for certain administrative expenses of the liquidation.

63. As a result of Touche Ross' aiding and abetting of the Weis Five's violation of the 1934 Act and the rules and regulations promulgated thereunder as discussed in paragraphs 60 and 61 hereinabove, and as a result of the consequent depletion of the SIPC fund as indicated in paragraph 62 hereinabove, SIPC has suffered and will continue to suffer damages in an amount which is presently estimated to be at least $14,000,000.

As And For Plaintiff SIPC's Fourth Cause Of Action

64. Plaintiff SIPC repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

65. Touche Ross had knowledge of or, but for its errors and omissions, should have had knowledge of the deception caused by the Weis Five, in violation of the 1934 Act and the rules and regulations promulgated thereunder, by means of the filing or dissemination of the 1972 Opinion Letters and the accompanying Answers to the Financial Questionnaire and financial statements.

66. Touche Ross breached the duties it owed to the customers and certain other creditors of Weis by failing to inquire as to, and to disclose, the deception caused by the Weis Five, in violation of the 1934 Act and the rules and regulations promulgated thereunder, by means of the filing or dissemination of the 1972 Opinion Letters and accompanying Answers to the Financial Questionnaire and financial statements.

67. The SIPC fund has been or may be depleted in order to satisfy the claims of over 34,000 customers and certain other creditors of Weis and to pay for certain administrative expenses of the liquidation.

68. But for Touche Ross' aiding and abetting of the Weis Five's violation of the 1934 Act and the rules and regulations promulgated thereunder, as discussed in paragraphs 65 and 66 hereinabove, the SIPC fund would not have been depleted to the extent that it has been, if at all, and consequently SIPC is subrogated to those claims which such customers and certain other creditors of Weis who have been paid out of the SIPC fund could have asserted against Touche Ross based on the auditing and accounting services performed by Touche Ross with respect to Weis.

69. The aggregate of the claims of Weis' customers and certain other creditors which have been satisfied out of the SIPC fund and for which Touche Ross is liable to SIPC is presently estimated to be at least $14,000,000.

As And For Plaintiff SIPC's Fifth Cause Of Action

70. Plaintiff SIPC repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

71. As a consequence of the liquidation of Weis, SIPC was required to satisfy the claims of over 34,000 customers and certain other creditors of Weis and to pay for certain administrative expenses of the liquidation.

72. As a result of the negligence and malpractice of Touche Ross, including that set forth in paragraphs 28 through 30 herein, and not as a result of any negligence of SIPC, SIPC has suffered and will continue to suffer damages in an amount which is presently estimated to be at least $14,000,000.

As And For Plaintiff SIPC's Sixth Cause Of Action

73. Plaintiff SIPC repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

74. As a result of the negligence and malpractice of Touche Ross, including that set forth in paragraphs 28 through 30 herein (and not as a result of any negligence of any customer or creditor of Weis), the customers and certain other creditors of Weis were misled into believing or assuming that Weis was not in financial difficulty, and consequently over 34,000 of said customers and creditors ultimately filed claims in the Weis liquidation proceeding.

75. The SIPC fund has been or may be depleted in order to satisfy the claims of the over 34,000 customers and certain other creditors of Weis, hereinabove mentioned in paragraph 74, and to pay for certain administrative expenses of the liquidation.

76. But for Touche Ross' negligence and malpractice, the SIPC fund would not have been depleted to the extent that it has been, if at all, and consequently SIPC is subrogated to these claims which such customers and certain other creditors of Weis who have been paid out of the SIPC fund could have asserted against Touche Ross based on the auditing and accounting services performed by Touche Ross with respect to Weis.

77. The aggregate of the claims of Weis' customers and certain other creditors which have been satisfied out of the SIPC fund and for which Touche Ross is liable to SIPC is presently estimated to be at least $14,000,000.

As and For Plaintiff SIPC's Seventh Cause of Action

78. Plaintiff SIPC repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

79. As a consequence of the liquidation of Weis, the SIPC fund has been or may be depleted in order to satisfy the claims of over 34,000 customers and certain other creditors of Weis and to pay for certain administrative expenses of the liquidation.

80. As a result of the malpractice of Touche Ross and its breach of the duties it owed to SIPC (and not as a result of any negligence of SIPC), in that the auditing and accounting services performed by Touche Ross were conducted in so reckless and grossly negligent a manner that Touche Ross knew or should have known that the 1972 Opinion Letters and the accompanying Answers to the Financial Questionnaire and financial statements were false, inaccurate and incomplete, SIPC has suffered and will continue to suffer damages in an amount which is presently estimated to be at least $14,000,000.

As And For Plaintiff SIPC's Eighth Cause Of Action

81. Plaintiff SIPC repeats and realleges each and every allegation contained in paragraphs 1 through 31 herein as though here set forth in full.

82. As a result of the malpractice of Touche Ross and its breach of the duties it owed to the customers and certain other creditors of Weis (and not as a result of any negligence of any customer or creditor of Weis), in that the auditing and accounting services performed by Touche Ross were conducted in so reckless and grossly negligent a manner that Touche Ross knew or should have known that the 1972 Opinion Letters and the accompanying Answers to the Financial Questionnaire and financial statements were false, inaccurate and incomplete, the customers and certain other creditors of Weis were misled into believing or assuming that Weis was not in financial

difficulty, and consequently over 34,000 of said customers and certain other creditors ultimately filed claims in the Weis liquidation proceeding.

83. The SIPC fund has been or may be depleted in order to satisfy the claims of the over 34,000 customers and certain other creditors of Weis, hereinabove mentioned in paragraph 82, and to pay for certain administrative expenses of the liquidation.

84. But for Touche Ross' malpractice, recklessness and gross negligence, the SIPC fund would not have been depleted to the extent that it has been, if at all, and consequently SIPC is subrogated to those claims which such customers and certain other creditors of Weis who have been paid out of the SIPC fund could have asserted against Touche Ross based on the auditing and accounting services performed by Touche Ross with respect to Weis.

85. The aggregate of the claims of Weis' customers and certain other creditors which have been satisfied out of the SIPC fund and for which Touche Ross is liable to SIPC is presently estimated to be at least $14,000,000.

Wherefore, plaintiffs demand judgment:

a. for $51,000,000 on Plaintiff Trustee's First Cause of Action;

b. for $51,000,000 on Plaintiff Trustee's Second Cause of Action;

c. for $51,000,000 on Plaintiff Trustee's Third Cause of Action;

d. for $51,000,000 on Plaintiff Trustee's Fourth Cause of Action;

e. for the amount of the Touche Ross Fee plus $51,000,000 on Plaintiff Trustee's Fifth Cause of Action;

f. for an amount which is the difference between the actual and warranted values of Touche Ross' services with respect to Weis, plus $51,000,000, on Plaintiff Trustee's Sixth Cause of Action;

g. for $14,000,000 on Plaintiff SIPC's First Cause of Action;

h. for $14,000,000 on Plaintiff SIPC's Second Cause of Action;

i. for $14,000,000 on Plaintiff SIPC's Third Cause of Action;

j. for $14,000,000 on Plaintiff SIPC's Fourth Cause of Action;

k. for $14,000,000 on Plaintiff SIPC's Fifth Cause of Action;

l. for $14,000,000 on Plaintiff SIPC's Sixth Cause of Action;

m. for $14,000,000 on Plaintiff SIPC's Seventh Cause of Action;

n. for $14,000,000 on Plaintiff SIPC's Eighth Cause of Action;

o. for interest on the amounts demanded herein;

p. for the costs and disbursements of this action; and

q. for such other, further and different relief as to the Court may seem just and proper.

Dated: New York, New York
April 30, 1976

HUGHES HUBBARD & REED

By /s/ JOHN S. ALLEE
A Member of the Firm
Attorneys for Edward S. Redington, as Trustee for the liquidation of the business of Weis Securities, Inc.
One Wall Street
New York, New York 10005
(212) WH 3-6500

HAWKINS, DELAFIELD & WOOD

By /s/ CLARENCE FRIED
A Member of the Firm
Attorneys for Securities Investor Protection Corporation
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Exhibit A to Complaint

WEIS, VOISIN & CO., INC.

REPORT ON EXAMINATION OF STATEMENT OF FINANCIAL CONDITION

MAY 26, 1972

TOUCHE ROSS & CO.

TOUCHE ROSS & CO.

WEIS, VOISIN & CO., INC.

REPORT ON EXAMINATION OF STATEMENT OF FINANCIAL CONDITION

MAY 26, 1972

TOUCHE ROSS & CO.

1633 BROADWAY
NEW YORK, NEW YORK 10019

July 7, 1972

Board of Directors
Weis, Voisin & Co., Inc.
New York, New York

We have examined the accompanying statement of financial condition of Weis, Voisin & Co., Inc. as of May 26, 1972. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the statement of financial condition referred to above presents fairly the financial position of Weis, Voisin & Co., Inc. at May 26, 1972, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding period.

Touche Ross & Co.
Certified Public Accountants

WEIS, VOISIN & CO., INC.

STATEMENT OF FINANCIAL CONDITION

MAY 26, 1972

ASSETS

Cash	$ 1,758,766
Deposits with clearing organizations and others	753,033
Receivables from brokers and dealers	8,775,852
Receivables from customers	76,376,206
Secured demand notes of subordinated lenders (collateralized by securities, at quoted market $6,625,570)	4,226,794
Miscellaneous receivables	3,610,935
Securities in firm trading and investment accounts:	
Marketable securities, at quoted market	3,542,457
Securities not readily marketable, at fair value	949,908
Securities held under subordination agreements, at quoted market	5,460,751
Investment in and advances to subsidiaries, at cost, plus equity in undistributed earnings	1,153,583
Exchange memberships:	
Owned, at cost (last sales prices $1,044,606)	1,289,938
Held under subordination agreement, at last sales prices	421,494
Leasehold improvements, office furniture and fixtures, at cost, less accumulated amortization and depreciation of $789,960	3,048,296
Excess of investment over net assets acquired, less accumulated amortization of $76,465 (Note 1)	2,217,403
Miscellaneous other assets	1,983,371
	$115,568,787

See notes to statement of financial condition

WEIS, VOISIN & CO., INC.

STATEMENT OF FINANCIAL CONDITION

MAY 26, 1972

LIABILITIES AND STOCKHOLDERS' EQUITY

Short-term bank loans, collateralized by customers' margin accounts securities		$ 47,575,000
Short-term bank loans, collateralized by securities owned by the Company or covered by subordination agreements		6,912,245
Payables to brokers and dealers		14,311,794
Payables to customers, including $6,791,886 of fee credit balances		16,770,379
Securities sold but not yet purchased, at quoted market		2,967,457
Accounts payable and accrued expenses		2,731,488
Due to lessors on lease contracts capitalized		1,475,215
Subordinated liabilities and stockholders' equity:		
Liabilities subordinated to all claims of general creditors (Note 2)	$15,237,951	
Stockholders' equity:		
Capital stock (Note 2)	2,374,800	
Additional paid-in capital	2,767,078	
Retained earnings	3,811,397	
	8,953,275	
Less treasury stock, at cost	1,366,017	
	7,587,258	22,825,209
Contingencies and commitments (Note 3)		
		$115,568,787

WEIS, VOISIN & CO., INC.

NOTES TO

STATEMENT OF FINANCIAL CONDITION

MAY 26, 1972

NOTE 1:

As of October 1, 1971, the Company acquired certain specified assets and assumed certain specified liabilities of Scheinman, Hockstein & Trotta, Inc., a member firm of the New York Stock Exchange. This acquisition has been accounted for as a purchase and the excess of investment over net assets acquired is being amortized over a twenty-year period.

NOTE 2:

The capital stock of the Company is composed of the following classes of stock:

Description	Number of shares: Authorized	Issued	Outstanding	In treasury	Amount
Common, par value $1, Class A (voting)	150,000	150,000	110,948	39,052	$ 150,000
Common, par value $1, Class B (non-voting)	150,000	150,000	149,080	920	150,000
Preferred, par value $100, Class A	55,000	16,248	10,273	5,975	1,624,800
Preferred, par value $100, Class B, 1% cumulative, convertible	3,500	3,500	3,500	—	350,000
Preferred, par value $100, Class C, 1% cumulative, convertible	2,500	1,000	1,000	—	100,000
Preferred, par value $100, Class D, 6% cumulative	10,000	—	—	—	—
					$2,374,800

The Company has granted stock options to subordinated lenders to purchase Class B, non-voting common stock as follows:

Option granted	Exercise amount	Expiration date
Shares equal to 2% of total Class A and Class B common stock issued and outstanding at the exercise date	2% of total stockholders' equity at exercise date	1976
10,907 shares	$25 per share	1975
2,000 shares	$35,000	Upon termination of subordination agreement

The exercise of these options is subject to the written approval of the New York Stock Exchange.

NOTE 3:

Aggregate rental commitments at May 26, 1972, under material noncancelable leases for premises were approximately $34,650,000 payable as follows:

Fiscal year ending	Amount
May 25, 1973	$ 3,000,000
May 31, 1974	2,825,000
May 30, 1975	2,875,000
May 28, 1976	2,750,000
May 27, 1977	2,725,000
May 26, 1978-1991	20,475,000

Exhibit B to Complaint

WEIS, VOISIN & CO., INC.

ANSWERS TO FINANCIAL QUESTIONNAIRE

AND ADDITIONAL INFORMATION

MAY 26, 1972

TOUCHE ROSS & CO.

WEIS, VOISIN & CO., INC.

ANSWERS TO FINANCIAL QUESTIONNAIRE

AND ADDITIONAL INFORMATION

MAY 26, 1972

TOUCHE ROSS & CO.

WEIS, VOISIN & CO., INC.

ANSWERS TO FINANCIAL QUESTIONNAIRE AND ADDITIONAL INFORMATION MAY 26, 1972

CONTENTS

	Page number
Report of independent certified public accountants	1
Answers to financial questionnaire:	
Part I	2-11
Additional information:	
Report of independent certified public accountants	12
Net capital computation	13-18
Report on internal controls by independent certified public accountants	19

NOTE: In accordance with general instructions regarding the preparation of this questionnaire, questions and subdivisions have been omitted where the respondent had nothing to report.

TOUCHE ROSS & CO.

1633 BROADWAY
NEW YORK, NEW YORK 10019

July 7, 1972

Board of Directors
Weis, Voisin & Co., Inc.
New York, New York

We have examined the answers to the financial questionnaire of Weis, Voisin & Co., Inc. as of May 26, 1972. Our examination was made in accordance with generally accepted auditing standards, and accordingly included a review of the accounting system, internal accounting control and the procedures for safeguarding securities including such tests thereof for the period since the prior examination date and such other auditing procedures as we considered necessary in the circumstances, including the audit procedures prescribed by the New York Stock Exchange and the Securities and Exchange Commission.

In our opinion, the accompanying answers to the financial questionnaire present fairly the financial position of Weis, Voisin & Co., Inc. at May 26, 1972, in the form prescribed by the New York Stock Exchange and the Securities and Exchange Commission, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding period.

Touche Ross & Co.
Certified Public Accountants

WEIS, VOISIN & CO., INC.

ANSWERS TO FINANCIAL QUESTIONNAIRE

MAY 26, 1972

PART I

Question number and title of account	Ledger balance		Security valuation		Commodity contracts	
	Debit	Credit	Long	Short	Losses	Gains
1. Bank balances and other deposits:						
Cash on Hand	$ 11,935					
Cash on deposit:						
Subject to immediate withdrawal	1,482,856					
Segregated under the Commodity Exchange Act	263,975					
Guaranty deposits with clearing organizations:						
General funds	599,143			$ 445,960		
Segregated under the Commodity Exchange Act	25,010					
Good faith deposits—brokers and dealers—Current	128,880					
2. Money borrowed, and accounts carried for respondent by other banking or brokerage houses, secured by or containing customers' collateral:						
A. Money borrowed:						
1. From banks, trust companies and other financial institutions		$47,575,000		71,372,501		
B. Accounts carried by other banking or brokerage houses:						
1. Securities accounts:						
a. Accounts with net debit balance, National Clearing Corp.	453,361		$1,257,102	889,204		
b. Accounts with net credit balance, Pacific Coast Stock Exchange Clearing Corp.		197,272	193,123	314,089		
2. Commodities accounts—futures:						
a. Regulated commodities accounts:						
ii. Accounts liquidating to a deficit	176,914				$15,374	$49,214
b. Non-regulated commodities accounts:						
ii. Accounts liquidating to a Deficit	44,022				16,140	30,839
3. Money borrowed, and accounts carried for respondent by other banking or brokerage houses, unsecured, or secured entirely by collateral owned by respondent and/or its officers and directors, or by securities covered by "satisfactory subordination agreements":						
A. Money borrowed:						
1. From banks, trust companies and other financial institutions		6,912,245		12,806,501		

WEIS, VOISIN & CO., INC.

ANSWERS TO FINANCIAL QUESTIONNAIRE

MAY 26, 1972

PART I

Question number and title of account	Ledger balance		Security valuation		Commodity contracts	
	Debit	Credit	Long	Short	Losses	Gains
4. Other accounts and open items with brokers and dealers:						
A. Securities borrowed	$2,641,600		$2,590,700			
B. Securities failed to deliver:						
1. Outstanding less than 30 days	5,051,188		4,995,527			
2. Outstanding 30 days or more:						
30 through 39 calendar days	97,518		91,758			
40 through 49 calendar days	25,311		19,721			
50 through 59 calendar days	5,932		4,600			
60 calendar days or more	66,921		79,830			
C. Securities loaned:						
1. For customers		$8,158,872		$ 8,083,063		
2. For accounts reportable under 10, 11 and 12		344,928		350,387		
D. Securities failed to receive:						
1. For customers:						
a. Outstanding less than 30 days		4,870,326		4,963,022		
b. Outstanding 30 days or more		222,859		251,152		
3. For accounts reportable under 10, 11 and 12:						
a. Outstanding less than 30 days		405,333		422,999		
b. Outstanding 30 days or more		6,071		5,516		
E. Open transactions in foreign securities with other brokers	213,085	57,594	708,348	1,502,139		
5. Valuation of securities in box, transfer and transit:						
A. Negotiable securities in box and in transfer				37,949,184		

WEIS, VOISIN & CO., INC.

ANSWERS TO FINANCIAL QUESTIONNAIRE

MAY 26, 1972

PART I

Question number and title of account	Ledger balance		Security valuation		Commodity contracts	
	Debit	Credit	Long	Short	Losses	Gains
6. Customers' securities accounts:						
A. Cash accounts:						
1. Accounts with debit balances	$ 4,201,268		$ 5,734,085	$ 346,799		
2. Accounts with credit balances		$5,263,785	1,616,717	5,656,274		
B. Secured Accounts:						
1. Accounts with debit balances	71,823,113		96,673,766	1,719,750		
2. Accounts with credit balances		3,207,453	562,761	3,240,069		
C. Partly secured accounts (see Reserve—Question 13):						
2. Accounts with credit balances		196		2,660		
D. Unsecured accounts (see Reserve—Question 13)	419,241			35,274		
E. Accounts with credit balances having open contractual commitments		760,916	101,005			
F. Accounts with free credit balances		6,791,886				
G. Fully paid securities not segregated:						
1. Segregation instructions issued:						
a. Securities failed to receive			1,021,791			
b. Securities due from customers			4,293,950			
c. Pending execution of instructions (based on tests, substantially all cleared within three business days)			8,704,928			
2. Substantially all in process of sale (based on tests)			7,730,105			
7. Customers' commodities accounts:						
A. Accounts with open future contracts liquidating to an equity:						
1. Regulated commodities		269,566			$36,216	$23,281
2. Non-regulated commodities		275,749			34,608	36,058
D. Unsecured debit balances	6,170					
E. Accounts with free credit balances:						
1. Regulated		143,613				
2. Non-regulated		46,871				

WEIS, VOISIN & CO., INC.

ANSWERS TO FINANCIAL QUESTIONNAIRE

MAY 26, 1972

PART I

Question number and title of account	Ledger balance		Security valuation		Commodity contracts	
	Debit	Credit	Long	Short	Losses	Gains
8. Accounts of officers and directors:						
A. Officers:						
1. Securities accounts:						
A. Bona fide cash accounts:						
1. Accounts with debit balances	$ 13,689		$ 14,600			
B. Secured accounts:						
1. Accounts with debit balances	101,240		117,326			
F. Accounts with free credit balances		$ 10,344				
G. Fully paid securities not segregated			11,400			
10. Trading and investment accounts of respondents:						
A. Securities accounts:						
1. Exempt securities	3,255,793	1,707,061	506,000			
2. Other securities			2,749,793	$1,707,061		
C. Arbitrage account	1,236,572	1,260,396	1,236,572	1,260,396		

WEIS, VOISIN & CO., INC.

ANSWERS TO FINANCIAL QUESTIONNAIRE

MAY 26, 1972

PART I

Question number and title of account	Ledger balance		Security valuation		Commodity contracts	
	Debit	Credit	Long	Short	Losses	Gains
11. Capital accounts:						
C. Corporation capital:						
1. Capital stock:						
A. Authorized:						
Class A, $1 par—150,000 shares						
Class B, $1 par—150,000 shares						
Preferred A, $100 par—55,000 shares						
Preferred B, $100 par, 1% cumulative, convertible—3,500 shares						
Preferred C, $100 par, 1% cumulative, convertible—2,500 shares						
Preferred D, $100 par, 6% cumulative—10,000 shares						
B. Issued:						
Class A, $1 par—150,000 shares		$ 150,000				
Class B, $1 par—150,000 shares		150,000				
Preferred A, $100 par—16,248 shares		1,624,800				
Preferred B, $100 par, 1% cumulative, convertible—3,500 shares		350,000				
Preferred C, $100 par, 1% cumulative, convertible—1,000 shares		100,000				
C. Treasury stock:						
Class A, $1 par—39,052 shares	$ 750,071					
Class B, $1 par—920 shares	18,400					
Preferred A, $100 par—5,975.46 shares	597,546					
2. Paid-in capital		2,767,078				
3. Retained earnings		3,811,397				

WEIS, VOISIN & CO., INC.

ANSWERS TO FINANCIAL QUESTIONNAIRE

MAY 26, 1972

PART I

Question number and title of account	Ledger balance		Security valuation		Commodity contracts	
	Debit	Credit	Long	Short	Losses	Gains
12. Subordinated accounts and borrowings:						
A. Subordinated accounts:						
Officer and directors:						
1. Accounts with debit balances	$ 39,939		$ 82,148			
2. Accounts with credit balances		$ 478,856	698,662			
3. Securities not readily marketable			96,157			
Debenture holders:						
1. Accounts with debit balances	14,998		116,062			
2. Accounts with credit balances		4	8,670			
Customers:						
1. Accounts with debit balances	690,260		1,431,460			
2. Accounts with credit balances		2,256,768	3,005,725			
3. Securities not readily marketable			21,867			
B. Other subordinated borrowings:						
Subordinated exchange memberships at market		421,494				
Subordinated debentures		3,110,275				
Secured demand notes—see Question 13		4,255,000				

WEIS, VOISIN & CO., INC.

ANSWERS TO FINANCIAL QUESTIONNAIRE

MAY 26, 1972

PART I

Question number and title of account	Ledger balance		Security valuation		Commodity contracts	
	Debit	Credit	Long	Short	Losses	Gains
13. Other accounts:						
Exchange memberships:						
Owned by respondent—at cost	$1,289,938					
Owned by stockholders (subordinated)—at last sales prices	421,494					
Leasehold improvements, office furniture and fixtures—at cost, less accumulated amortization and depreciation of $188,916	1,341,057					
Commodity difference accounts:						
Regulated		$ 19,473			$19,473	
Non-regulated		17,581			17,581	
Loans and advances	99,458					
Commissions receivable—last five trade dates	432,107					
Insurance claim receivable re Winslow, Cohu & Stetson, Inc.	1,285,401					
Investment in and advances to subsidiaries—at equity	1,153,583					
Receivable from stockholders	768,199					
Miscellaneous receivables:						
Current	503,058					
Other	108,471					
Prepaid expenses and deposits	551,138					
Deferred charges	395,901					
Dividends and interest receivable, payable and unclaimed:						
Current (outstanding less than 30 days)	48,991	120,373	$ 635,277	$591,771		
Not current	135,067	97,729	233,431	92,607		
Scheinman, Hochstin & Trotta, Inc. liquidating omnibus account	745,238					
Secured demand notes receivable from subordinated lenders, collateralized by:	4,255,000					
Cash		28,206				
Exempt securities			1,871,420			
Non-exempt securities			4,754,150			
Due from member firm	91,123					
Excess of investment over net assets acquired, less accumulated amortization of $76,465	2,217,403					
Accrued customers' interest receivable—current	139,060					

WEIS, VOISIN & CO., INC.

ANSWERS TO FINANCIAL QUESTIONNAIRE

MAY 26, 1972

PART I

Question number and title of account	Ledger balance Debit	Ledger balance Credit	Security valuation Long	Security valuation Short	Commodity contracts Losses	Commodity contracts Gains
13. Other accounts (continued):						
Purchased public relations contracts re acquisition of Thomas J. Deegan & Co., Inc., less accumulated amortization of $29,432	$ 291,094					
Leasehold improvements, office furniture and fixtures—at cost acquired under lease contracts, less accumulated amortization and depreciation of $601,044	1,707,239					
Due to lessors on lease contracts capitalized		$ 1,475,215				
Other liabilities		946,245				
Reserve for doubtful accounts		200,000				
Accrued interest payable		275,562				
Accrued salaries and commissions		652,583				
Floor brokerage payable		74,778				
Federal, state, and local taxes payable on income		564,218				
Unlocated security differences			$ 43,821	$ 5,980		
	$112,435,971	$112,435,971	$154,014,358	$154,014,358	$139,392	$139,392

NOTE TO QUESTION 13:

Security count differences, discovered through physical count and verification procedures pursuant to Rule 17a-5 and 17a-13, classified by date of discovery, which remained unresolved or were bought or sold since the last examination date are as follows:

	Date of discovery	Number of securities	Security valuation Long	Security valuation Short
Unresolved differences	May 26, 1972	60	$43,821	$5,980
Securities bought or sold:			Bought	Sold
	March 24, 1972	3		$7,800
	November 26, 1971	1		160

There were 14,624 securities with positions at May 26, 1972.

WEIS, VOISIN & CO., INC.

ANSWERS TO FINANCIAL QUESTIONNAIRE

MAY 26, 1972

PART I

16. Unrecorded assets, liabilities, and accountabilities:

Under 31 leases for premises in effect as of May 26, 1972, aggregate annual rentals are as follows:

Fiscal year ending	
May 25, 1973	$ 3,000,000
May 31, 1974	2,825,000
May 30, 1975	2,875,000
May 28, 1976	2,750,000
May 27, 1977	2,725,000
May 26, 1978—1991	20,475,000

WEIS, VOISIN & CO., INC.

ANSWERS TO FINANCIAL QUESTIONNAIRE

MAY 26, 1972

PART I

NOTE

The Company has granted stock options to subordinated lenders to purchase Class B, non-voting common stock as follows:

Option granted	Exercise amount	Expiration date
Shares equal to 2% of total Class A and Class B common stock issued and outstanding at the exercise date	2% of total stockholders' equity at exercise date	1976
10,907 shares	$25 per share	1975
2,000 shares	$35,000	Upon termination of subordination agreement

The exercise of these options is subject to the written approval of the New York Stock Exchange.

ADDITIONAL INFORMATION

The additional information presented in the following pages which has been taken primarily from accounting and other records of the Respondent has been subjected to the tests and other auditing procedures applied in our examination of the answers to financial questionnaire of Weis, Voisin & Co., Inc. as of May 26, 1972. In our opinion, such information is fairly presented in all material respects in relation to the answers to the financial questionnaire taken as a whole although it is not necessary for a fair presentation of financial position.

Touche Ross & Co.
Certified Public Accountants

WEIS, VOISIN & CO., INC.

NET CAPITAL COMPUTATION

MAY 26, 1972

SUMMARY

Aggregate indebtedness		$80,315,478
1/15 of aggregate indebtedness		$ 5,354,365
Net capital:		
Total credit items	$30,099,473	
Total debit items	21,867,090	
NET CAPITAL		8,232,383
Capital in excess of minimum requirements		$ 2,878,018
Ratio of indebtedness to capital		976%

WEIS, VOISIN & CO., INC.

NET CAPITAL COMPUTATION

MAY 26, 1972

Question number	Aggregate indebtedness	
2A1	Money borrowed, collateralized by customers' securities	$47,575,000
2B1	Credit balance in account carried by other banking or brokerage house	197,272
	Open items with brokers and dealers:	
4C1	Securities loaned—customers' securities	8,158,872
4D1	Securities failed to receive customers' securities	5,093,185
4E	Foreign securities transactions	57,594
	Customers' security accounts:	
6A2	Cash	5,263,785
6B2	Secured	3,207,453
6E	Accounts with credit balances having open contractual commitments	760,916
6F	Free credits	6,791,886
	Customers' commodity accounts:	
7A2	Equities in nonregulated commodities	277,199
7E1	Free credits—regulated	143,613
7E2	Free credits—nonregulated	46,871
8F	Securities and commodities accounts of officers and directors	10,344
13	Accrued interest payable	275,562
13	Accrued salaries and commissions	652,583
13	Floor brokerage payable	74,778
13	Dividends and interest payable	218,102
13	Federal, state and local taxes payable on income	564,218
13	Other liabilities	946,245
	Total aggregate indebtedness	$80,315,478

WEIS, VOISIN & CO., INC.

NET CAPITAL COMPUTATION

MAY 26, 1972

Question number	Credit items	
6C	Ledger balances in partly secured accounts	$ 196
10	Firm trading and investment accounts:	
	Securities long	3,255,793
	Credit balance	1,707,061
11	Capital stock—A	150,000
11	Capital stock—B	150,000
11	Capital stock—Preferred—A	1,624,800
11	Capital stock—Preferred—B	350,000
11	Capital stock—Preferred—C	100,000
11	Paid-in capital	2,767,078
11	Retained earnings	3,811,397
12A	Subordinated lenders' ledger balances—officers and directors	478,856
12A	Subordinated lenders' ledger balances—debenture holders	4
12A	Subordinated lenders' ledger balances—customers	2,256,768
12A	Securities in subordinated lenders' accounts	5,460,751
12B	Other subordinated borrowings —memberships	421,494
12B	Other subordinated borrowings —debentures	3,110,275
12B	Other subordinated borrowings —secured demand notes	4,255,000
13	Reserve for doubtful accounts	200,000
	Total credit items	$30,099,473

WEIS, VOISIN & CO., INC.

NET CAPITAL COMPUTATION

MAY 26, 1972

Question number	Debit items	
6C	Short securities in partly secured accounts	$ 2,660
6D	Debit balances in unsecured accounts	419,241
6D	Short securities in unsecured accounts	35,274
7D	Debit balances in unsecured commodities accounts	6,170
10	Firm trading and investment accounts:	
	Securities short	1,707,061
	Debit balance	3,255,793
11	Treasury stock, class A	750,071
11	Treasury stock, class B	18,400
11	Treasury stock, preferred A	597,546
12A	Subordinated lenders' ledger balances —officers and directors	39,939
12A	Subordinated lenders' ledger balances —debenture holders	14,998
12A	Subordinated lenders' ledger balances —customers	690,260
13	Exchange memberships—firm	1,289,938
13	Exchange memberships—subordinated lenders	421,494
13	Leasehold improvements, furniture and fixtures ect.	1,341,057
13	Miscellaneous receivables	108,471
13	Loans and advances	99,458
13	Insurance claims receivable re Winslow, Cohu & Stetson, Inc.	1,285,401
13	Investments in and advances to subsidiaries at equity	1,153,583

Question number	Debit items		
13	Prepaid expenses and deposits		551,138
13	Deferred charges		395,901
13	Dividends and interest receivable— noncurrent		135,067
13	Short securities receivable—dividends		92,607
13	Excess of investment over net assets acquired		2,217,403
13	Receivable from stockholders		768,199
13	Due from member firm		91,123
13	Purchased public relations contracts re acquisition of Thomas J. Deegan & Co., Inc.		291,094
13	Leasehold improvements, office furniture and fixtures, acquired under lease contracts	1,707,239	
	Less amount due to lessors	1,475,215	232,024
13	Scheinman, Hochstin & Trotta, Inc. liquidating omnibus account		745,238
13	Unlocated security differences—short		5,980
	Charges to capital:		
	"Haircuts" (Schedule 1):		
	Subordinated lenders—customers		1,170,062
	Subordinated lenders—debenture holders		36,580
	Subordinated lenders—officers and directors		295,194
	Firm accounts		1,529,962
	1½% of value of commodities		48,910
	Penalties on fails to deliver		23,793
	TOTAL DEBIT ITEMS		$21,867,090

WEIS, VOISIN & CO., INC.

NET CAPITAL COMPUTATION

MAY 26, 1972

SUMMARY OF CAPITAL CHARGES

	Long Security value	Capital charge %	Capital charge Amount
Subordinated accounts:			
Customers	$ 990	—	$ —
	19,500	1	195
	29,300	2	586
	206,400	5	10,320
	532,000	10	53,200
	66,500	15	9,975
	8,300	20	1,660
	21,867	100	21,867
	3,574,195	30	1,072,259
	$4,459,052		$1,170,062
Debenture holders	$ 5,600	15	$ 840
	119,132	30	35,740
	$ 124,732		36,580
Officers and directors	$ 2,475	—	—
	5,200	2	104
	27,780	3	833
	82,850	5	4,143
	10,500	10	1,050
	10,100	15	1,515
	11,800	20	2,360
	96,157	100	96,157
	630,105	30	189,032
	$ 876,967		295,194

	Long Security value	Capital charge %	Capital charge Amount
Firm accounts	$1,261,635	—	—
	66,482	2	1,330
	238,655	3	7,160
	53,461	5	2,673
	3,350	10	335
	122,950	15	18,443
	56,678	50	28,339
	949,908	100	949,908
	1,739,246	30	521,774
	$4,492,365		1,529,962
Commodities:			
Fails to deliver:			
40 through 49 days	$ 25,311	10	2,531
50 through 59 days	5,932	20	1,186
60 days or more	66,921	30	20,076
	$ 98,164		23,793
			$3,055,591

WEIS, VOISIN & CO., INC.

REPORT ON INTERNAL CONTROL

MAY 26, 1972

We have examined the financial statements of Weis, Voisin & Co., Inc. for the period ended May 26, 1972 and have issued our report thereon dated July 7, 1972. As a part of our examination, we reviewed and tested the Company's system of internal accounting control to the extent we considered necessary to evaluate the system as required by generally accepted auditing standards. Under these standards the purpose of such evaluation is to establish a basis for reliance thereon in determining the nature, timing, and extent of other auditing procedures that are necessary for expressing an opinion on the financial statements.

The objective of internal accounting control is to provide reasonable, but not absolute, assurance as to the safeguarding of assets against loss from unauthorized use or disposition, and the reliability of financial records for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that the cost of a system of internal accounting control should not exceed the benefits derived and also recognizes that the evaluation of these factors necessarily requires estimates and judgments by management.

There are inherent limitations that should be recognized in considering the potential effectiveness of any system of internal accounting control. In the performance of most control procedures, errors can result from misunderstanding of instructions, mistakes of judgment, carelessness or other personal factors. Control procedures whose effectiveness depends upon segregation of duties can be circumvented by collusion. Similarly, control procedures can be circumvented intentionally by management with respect either to the execution and recording of transactions or with respect to the estimates and judgments required in the preparation of financial statements. Further, projection of any evaluation of internal accounting control to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions, and that the degree of compliance with the procedures may deteriorate.

Our study and evaluation of the Company's system of internal accounting control for the period November 26, 1971, the prior examination date, to May 26, 1972 was made for the purpose set forth in the first paragraph above, and it would not necessarily disclose all weaknesses in the system. However, such study and evaluation disclosed no conditions that we believe to be material weaknesses.

Touche Ross & Co.
Certified Public Accountants

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Exhibit C to Complaint

WEIS, VOISIN & CO., INC.
AND SUBSIDIARIES

REPORT ON EXAMINATION OF CONSOLIDATED
FINANCIAL STATEMENTS

YEAR (52 WEEKS) ENDED MAY 26, 1972

TOUCHE ROSS & CO.

WEIS, VOISIN & CO., INC. AND SUBSIDIARIES

REPORT ON EXAMINATION OF CONSOLIDATED FINANCIAL STATEMENTS

YEAR (52 WEEKS) ENDED MAY 26, 1972

TOUCHE ROSS & CO.

1633 BROADWAY
NEW YORK, NEW YORK 10019

July 21, 1972

Board of Directors
Weis, Voisin & Co., Inc.
New York, New York

We have examined the accompanying consolidated balance sheet of Weis, Voisin & Co., Inc. and subsidiaries as of May 26, 1972, and the related statements of earnings, stockholders' equity and changes in financial position for the year (52 weeks) then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the consolidated financial statements referred to above present fairly the financial position of Weis, Voisin & Co., Inc. and subsidiaries at May 26, 1972, the results of their operations and changes in their financial position for the year (52 weeks) then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Touche Ross & Co.
Certified Public Accountants

WEIS, VOISIN & CO., INC.
AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET
MAY 26, 1972

ASSETS

Cash	$ 1,842,307
Deposits with clearing organizations and others	753,033
Receivables from brokers and dealers (Note 4)	8,775,852
Receivables from customers (Note 4)	76,376,206
Secured demand notes of subordinated lenders (collateralized by cash of $28,206 and securities, at quoted market $6,625,570) (Note 5)	4,226,794
Miscellaneous receivables (Note 9)	3,763,785
Securities owned (Note 6)	4,492,365
Securities held under subordination agreements, at quoted market (Note 5)	5,460,751
Exchange memberships:	
Owned, at cost (last sales prices $1,044,606)	1,289,938
Held under subordination agreements, at last sales prices (Note 5)	421,494
Leasehold improvements, office furniture and fixtures, at cost, less accumulated amortization and depreciation of $1,008,058 (Note 7)	3,513,321
Excess of investment over net assets acquired, less accumulated amortization of $76,465 (Note 3)	2,217,403
Miscellaneous other assets (Note 3)	2,396,602
	$115,529,851

See notes to consolidated financial statements

WEIS, VOISIN & CO., INC.
AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET
MAY 26, 1972

LIABILITIES AND STOCKHOLDERS' EQUITY

Short-term bank loans, collateralized by customers' margin accounts securities		$ 47,575,000
Short-term bank loans, collateralized by securities owned by the Company or covered by subordination agreements		6,912,245
Payables to brokers and dealers (Note 4)		14,311,794
Payables to customers (Note 4)		16,770,379
Securities sold but not yet purchased (Note 6)		2,967,457
Accounts payable and accrued expenses (Note 8)		2,952,582
Due to lessors on lease contracts capitalized (Note 7)		1,475,215
Subordinated liabilities and stockholders' equity:		
Liabilities subordinated to all claims of general creditors (Note 5)	$14,977,921	
Stockholders' equity (Notes 9 and 10):		
Capital stock	2,374,800	
Additional paid-in capital	2,767,078	
Retained earnings	3,811,397	
	8,953,275	
Less treasury stock, at cost	1,366,017	
	7,587,258	22,565,179
Contingencies and commitments (Notes 11 and 12)		
		$115,529,851

TOUCHE ROSS & CO.

WEIS, VOISIN & CO., INC.
AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF EARNINGS
YEAR (52 WEEKS) ENDED MAY 26, 1972

Revenues:		
Commissions:		
Customers		$19,160,975
Clearing brokers		762,745
Investment banking		5,191,186
Principal transactions (Note 6)		2,288,365
Interest		3,408,607
Fees		873,707
Other		161,718
		31,847,303
Expenses:		
Employee compensation	$15,575,609	
Commissions—clearing brokers	456,247	
Floor brokerage commissions	892,825	
Interest	3,120,501	
Office and equipment rentals	3,024,609	
Communications	2,596,221	
Other operating expenses	4,394,017	30,060,029
EARNINGS BEFORE TAXES ON INCOME		1,787,274
Taxes on income (Note 8)		765,000
NET EARNINGS		$ 1,022,274
Weighted average number of common and common equivalent shares outstanding (Note 13)		234,204
Earnings per common and common equivalent share (Note 13)		$4.36

See notes to consolidated financial statements

TOUCHE ROSS & Co.

WEIS, VOISIN & CO., INC.
AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
YEAR (52 WEEKS) ENDED MAY 26, 1972

	Capital stock issued							
	Number of shares							
	Common		Preferred					
	Class A par $1.00	Class B par $1.00	Class A, par $100.00	Class B par $100.00	Class C par $100.00	Amount	Additional paid-in capital	Retained earnings
Balance, June 1, 1971	150,000	150,000	16,248	—	—	$1,924,800	$2,469,921	$2,789,123
Issued	—	—	—	3,500	1,000	450,000	—	—
Excess of proceeds over cost of treasury stock sold:								
Common, Class A—29,375 shares	—	—	—	—	—	—	17,827	—
Common, Class B—40,750 shares	—	—	—	—	—	—	279,330	—
Net earnings for the year (52 weeks) ended May 26, 1972	—	—	—	—	—	—	—	1,022,274
Balance, May 26, 1972	150,000	150,000	16,248	3,500	1,000	$2,374,800	$2,767,078	$3,811,397

	Capital stock in treasury			
	Number of shares			
	Common		Preferred	
	Class A, par $1.00	Class B par $1.00	Class A, par $100.00	Cost
Balance, June 1, 1971	61,375	24,124	6,412.96	$ 2,162,929
Purchased	7,052	17,546	4,962.50	835,057
Sold	(29,375)	(40,750)	(5,400.00)	(1,631,969)
Balance, May 26, 1972	39,052	920	5,975.46	$ 1,366,017

See notes to consolidated financial statements

TOUCHE ROSS & Co.

WEIS, VOISIN & CO., INC.
AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION
YEAR (52 WEEKS) ENDED MAY 26, 1972

Source of funds:	
Operations:	
Net earnings	$ 1,022,274
Non-cash charges—depreciation and amortization	538,410
	1,560,684
Increase in:	
Short-term bank loans, collateralized by customers' margin account securities	31,073,040
Short-term bank loans, collateralized by securities owned by the Company or covered by subordination agreements	5,612,245
Payable to brokers and dealers	5,062,360
Payable to customers	5,642,327
Securities sold but not yet purchased	2,833,092
Liabilities subordinated to all claims of general creditors	6,474,117
Proceeds from issue of preferred stock	450,000
Proceeds from sale of treasury stock:	
Cost	1,631,969
Excess of proceeds over cost	297,157
Other sources	61,550
	60,698,541

[CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION—(Continued)]

Application of funds:	
Increase in:	
Deposits with clearing organizations	487,317
Receivables from brokers and dealers	4,064,603
Receivables from customers	42,799,812
Secured demand notes of subordinated lenders	4,226,794
Miscellaneous receivables	1,397,252
Securities owned	924,121
Securities held under subordination agreements	146,933
Exchange memberships owned	154,050
Exchange memberships held under subordination agreements	152,768
Miscellaneous other assets	1,750,911
Purchase of leasehold improvements and furniture and fixtures	1,937,996
Excess of investment over net assets acquired	2,217,403
Purchase of treasury stock	835,057
	61,095,017
Decrease in cash	$ 396,476

See notes to consolidated financial statements

WEIS, VOISIN & CO., INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. PRINCIPLES OF CONSOLIDATION:

The consolidated financial statements include the accounts of Weis, Voisin & Co., Inc. and all of its subsidiaries. The results of operations of companies purchased are included from the dates of acquisition. All significant intercompany balances and transactions have been eliminated in consolidation.

2. ACCOUNTING:

In 1972 the Company adopted a fiscal year consisting of the fifty-two or fifty-three week period ending the last Friday of May. Prior to 1972, the Company's fiscal year ended on May 31.

Security transactions are recorded in the accounts on settlement date. Commission income and related expenses for transactions executed but not settled are accrued on financial statement dates.

3. ACQUISITIONS:

Scheinman, Hochstin & Trotta, Inc.:

As of October 1, 1971, the Company acquired certain specified assets and assumed certain specified liabilities of Scheinman, Hochstin & Trotta, Inc. (SH&T), a former member firm of the New York Stock Exchange. This acquisition has been accounted for as a purchase and the excess of investment over net assets acquired of

$2,293,868 is being amortized over a twenty-year period.

As part of the purchase agreement a subordinated lender of SH&T agreed to become a subordinated lender of the Company and to indemnify the Company to a maximum of $4,000,000 in the event the assumed liabilities exceeded the acquired assets. Through May 26, 1972 the liabilities assumed exceed the assets acquired by approximately $750,000 which is included in miscellaneous other assets.

Thomas J. Deegan Company, Inc.:

As of July 1, 1971, the Company acquired the outstanding capital stock of Thomas J. Deegan Company, Inc. in exchange for 3,500 shares of its 1% cumulative convertible preferred par value $100, Class B stock. The Company is accounting for this acquisition as a purchase.

–2–

4. RECEIVABLES FROM AND PAYABLES TO BROKERS AND DEALERS AND CUSTOMERS:

The components of receivables from and payables to brokers and dealers as of May 26, 1972 are as follows:

Securities failed to deliver	$ 5,246,870
Deposits paid for securities borrowed	2,641,600
Other	887,382
Total receivables from brokers and dealers	$ 8,775,852
Securities failed to receive	$ 5,642,689
Deposits received for securities loaned	8,433,450
Other	235,655
Total payables to brokers and dealers	$14,311,794

"Fails" represent the contract value of securities which have not been received or delivered by settlement date.

Receivables from and payables to customers represent the dollar balances arising in connection with normal cash and margin transactions. The receivables are collateralized by securities held by the Company which are not reflected in the accompanying consolidated financial statements. Free credit balances totaling approximately $6,792,000 at May 26, 1972 are included in payables to customers. Accounts of officers, directors and stockholders are included in receivables from and payables to customers since they are subject to the normal terms and regulations as to payment and, in the aggregate, are not significant.

5. LIABILITIES SUBORDINATED TO ALL CLAIMS OF GENERAL CREDITORS:

Certain creditors of the Company have signed agreements subordinating their debentures, exchange memberships or securities accounts to all claims of general creditors, and thus the respective amounts are available to the Company in computing net capital under the New York Stock Exchange rule regarding capital requirements (see Note 10). These agreements generally specify release, payment, or redemption no less than six months following the date on which the lender demands termination subject to approval of the New York Stock Exchange. These liabilities at May 26, 1972 are summarized as follows:

	Rate of interest	
Debentures	7-10%	$ 3,110,275
Secured demand notes	8%	4,255,000
Exchange memberships	6-8%	421,494
Equities in securities accounts:		
Securities at quoted market	2.8-5%	5,460,751
Cash	4-10%	1,730,401
		$14,977,921

6. SECURITIES OWNED:

Securities owned at May 26, 1972 consist of the Company's regular trading and investment accounts and are summarized as follows:

		Cost
Marketable securities—at quoted market:		
U.S. Government bonds	$ 330,200	$ 332,560
Municipal bonds	175,800	162,587
Corporate debentures and note	69,718	69,608
Corporate stocks	1,730,167	1,745,421
Arbitrage (convertible within 30 days)	1,236,572	1,151,459
	3,542,457	3,461,635
Securities not readily marketable—at fair value	949,908	508,244
	$4,492,365	$3,969,879
Marketable securities sold but not yet purchased—at quoted market:		
Corporate debentures and notes	$ 24,734	$ 24,700
Corporate stocks	1,682,327	1,671,581
Arbitrage (convertible within 30 days)	1,260,396	1,192,206
	$2,967,457	$2,888,487

Quoted market has been determined by reference to available quotations as to marketable securities. The fair values of securities not readily marketable have been determined by management. Fair values as determined are, in the aggregate, not less than cost.

The increase in unrealized appreciation on securities owned for the fiscal year ended May 26, 1972 of $285,516 is included in principal transactions on the statement of earnings. The effect on net earnings (after taxes) is $170,667 or $.73 per share.

7. LEASEHOLD IMPROVEMENTS, OFFICE FURNITURE AND FIXTURES:

Leasehold improvements, office furniture and fixtures include approximately $2,300,000 of such assets acquired under lease contracts. The net book value of these assets of approximately $1,700,000 collateralizes the amounts due to lessors on lease contracts capitalized. The Company computes depreciation and amortization on the straight-line method for financial statement purposes (see Note 8).

8. TAXES ON INCOME:

Taxes on income indicate a significant variation in the customary relationship to earnings before taxes on income due to the effect of the different tax rates applied to ordinary income and capital gains, and because federal taxes on income were reduced by $113,000 of investment tax credit. The Company accounts for the investment tax credit by use of the flow-through method. Deferred

income taxes of $18,000 have been provided on the difference in depreciation and amortization for leasehold improvements, office furniture and fixtures acquired since June 1, 1971, computed by the double-declining balance method for tax purposes and the straight-line method for financial reporting purposes. The liability for taxes on income ($564,000 after reduction for estimated tax payments) at May 26, 1972 is included in accounts payable and accrued expenses.

9. STOCKHOLDERS' EQUITY:

The capital stock of the Company is composed of the following at May 26, 1972:

Description	Number of shares: Authorized	Issued	Outstanding	In treasury	Amount
Common, par value $1, Class A (voting)	150,000	150,000	110,948	39,052	$ 150,000
Common, par value $1, Class B (non-voting)	150,000	150,000	149,080	920	150,000
Preferred, par value $100, Class A	55,000	16,248	10,273	5,975	1,624,800
Preferred, par value $100, Class B, 1% cumulative, convertible	3,500	3,500	3,500	—	350,000
Preferred, par value $100, Class C, 1% cumulative, convertible	2,500	1,000	1,000	—	100,000
Preferred, par value $100, Class D, 6% cumulative	10,000	—	—	—	—
					$2,374,800

The Company has granted stock options (at option prices not less than fair market value as determined by the Company) to subordinated lenders to purchase Class B, non-voting common stock as follows:

Option granted	Exercise amount	Expiration date
Shares equal to 2% of total Class A and Class B common stock issued and outstanding at the exercise date	2% of total stockholders' equity at exercise date	1976
10,907 shares	$25 per share	1975
2,000 shares	$35,000	Upon termination of subordination agreement

The exercise of these options is subject to the written approval of the New York Stock Exchange.

Subject to certain anti-dilution provisions, the 3,500 shares of Class B preferred stock are convertible, in whole but not in part, into 3,500 shares each of Class A and Class B common stock and the 1,000 shares of Class C preferred stock are convertible, in whole but not in part, into 2,000 shares of Class B common stock.

As of May 26, 1972, $768,000 included in miscellaneous receivables in the accompanying consolidated balance sheet was due from employees in connection with the purchase of the Company's capital stock.

10. NET CAPITAL REQUIREMENTS:

The Company is required to comply with a New York Stock Exchange regulation which provides that the Company maintain a ratio of aggregate indebtedness to net capital, as defined, not exceeding 15 to 1. The excess net capital as computed under this rule was approximately $2,878,000 at May 26, 1972.

11. COMMITMENTS AND CONTINGENCIES:

There are various lawsuits pending against the Company which, in the opinion of management, will be resolved with no material adverse effect on the financial condition of the Company.

Aggregate rental commitments at May 26, 1972 under material noncancellable leases for premises were approximately $34,650,000 payable as follows:

Fiscal year ending	Amount
May 25, 1973	$ 3,000,000
May 31, 1974	2,825,000
May 30, 1975	2,875,000
May 28, 1976	2,750,000
May 27, 1977	2,725,000
May 26, 1978-1991	20,475,000

In the normal course of business, the Company enters into underwriting commitments. Transactions relating to underwriting commitments which were open as of May 26, 1972 and subsequently settled, had no material effect on the financial statements at that date.

12. PROFIT SHARING PLAN:

The Company has a non-contributory profit sharing plan, qualified under the Internal Revenue Code, which covers substantially all employees with more than one year's service. The plan is funded through a self-administered trust and may be terminated at any time by the Company. Contributions to the Trust are made at the sole discretion of the Company's Board of Directors. The amount charged to income during the year was $150,000.

13. EARNINGS PER SHARE:

Earnings per common share and common equivalent share were computed by dividing net earnings by the weighted-average number of Class A voting and Class B non-voting common shares and common share equivalents outstanding during the year. The number of common share equivalents outstanding during the year. The number of common share equivalents outstanding included, (1) weighted-average of 6,417 shares issuable on conversion of the Class B preferred stock, (2) weighted average of 1,360 shares issuable on conversion of the Class C preferred stock and (3) 600 shares issuable on exercise of stock options which are dilutive. All other stock options outstanding are anti-dilutive and are excluded in computing earnings per share.

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Exhibit D to Complaint

WEIS, VOISIN & CO., INC.
AND SUBSIDIARIES

REPORT ON EXAMINATION OF CONSOLIDATED FINANCIAL STATEMENTS

FIVE YEARS ENDED MAY 26, 1972

TOUCHE ROSS & CO.

WEIS, VOISIN & CO., INC. AND SUBSIDIARIES

REPORT ON EXAMINATION OF CONSOLIDATED FINANCIAL STATEMENTS

FIVE YEARS ENDED MAY 26, 1972

TOUCHE ROSS & CO.

1633 BROADWAY
NEW YORK, NEW YORK 10019

July 21, 1972

Board of Directors
Weis, Voisin & Co., Inc.
New York, New York

We have examined the accompanying consolidated balance sheet of Weis, Voisin & Co., Inc. and subsidiaries as of May 26, 1972, and the related statement of earnings for the five years then ended and the related statements of stockholders' equity and changes in financial position for the three years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned consolidated financial statements present fairly the financial position of Weis, Voisin & Co., Inc. and subsidiaries at May 26, 1972, and the results of their operations and the changes in their financial position for the periods indicated, in conformity with generally accepted accounting principles applied on a consistent basis.

Touche Ross & Co.
Certified Public Accountants

WEIS, VOISIN & CO., INC.
AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF EARNINGS

	Year ended May 31,				Year (52 weeks) ended May 26, 1972
	1968	1969	1970	1971	(Note A)
Revenues (Note B):					
Commissions (Note C):					
Customers	$10,069,939	$13,769,505	$10,834,529	$13,533,183	$19,160,975
Clearing brokers	8,077,966	9,684,578	7,887,924	3,011,337	762,745
Investment banking (Note D)	471,190	3,359,274	2,446,189	1,596,898	5,191,186
Principal transactions (Note E)	974,778	425,719	2,825,483	1,336,104	2,288,365
Interest (Note F)	2,378,745	3,532,765	4,979,995	2,748,397	3,408,607
Fees	348,755	385,860	298,150	803,270	873,707
Other	166,798	447,920	525,850	455,016	161,718
	22,488,171	31,605,621	29,298,120	23,484,205	31,847,303
Expenses:					
Employee compensation (Note G)	8,405,466	13,831,272	11,852,884	10,605,677	15,575,609
Commissions—clearing brokers	5,780,308	7,027,742	5,044,094	1,922,969	456,247
Floor brokerage commissions	1,470,879	1,539,924	1,044,958	861,370	892,825
Interest	1,128,850	1,589,146	3,112,488	2,247,205	3,120,501
Office and equipment rentals	784,998	1,423,922	1,971,289	2,074,299	3,024,609
Communications	777,153	1,219,448	2,023,393	1,842,214	2,596,221
Other operating expenses	2,113,091	4,114,189	3,624,121	3,245,782	4,394,017
	20,461,045	30,745,643	28,673,227	22,799,516	30,060,029
EARNINGS BEFORE TAXES ON INCOME	2,027,126	859,978	624,893	684,689	1,787,274
Taxes on income (Note H)	882,000	418,000	206,000	336,000	765,000
NET EARNINGS	$ 1,145,126	$ 441,978	$ 418,893	$ 348,689	$ 1,022,274
Weighted average number of common and common equivalent shares outstanding (Notes B and I)	211,429	213,136	238,605	219,114	234,204
Earnings per common and common equivalent share (Notes E, H and I)	$5.42	$2.07	$1.76	$1.59	$4.36

See notes to consolidated statement of earnings

WEIS, VOISIN & CO., INC.
AND SUBSIDIARIES

NOTES TO CONSOLIDATED STATEMENT OF EARNINGS

NOTE A:

In 1972 the Company adopted a fiscal year consisting of the fifty-two or fifty-three week period ending the last Friday of May. Prior to 1972, the Company's fiscal year ended on May 31.

Security transactions are recorded in the accounts on settlement date. Commission income and related expenses for transactions executed but not settled are accrued on financial statement dates.

NOTE B:

As discussed in Note 2 to the consolidated financial statements, the Company acquired certain specified assets and assumed certain specified liabilities of Scheinman, Hochstin & Trotta, Inc., and acquired certain selected assets of Winslow, Cohu & Stetson, Incorporated and undertook to liquidate its assets and liabilities. The statement of earnings reflects operations of these acquisitions from their respective acquisition dates. Separate statements of operations of these companies are not included because both acquisitions were of offices, registered representatives and customers together with related assets. Since processing operations and associated costs of both companies have been eliminated, presentation of past operational data and pro forma statements of operations for periods prior to acquisition would not be meaningful.

The statement of earnings reflects operations of VCL Associates, a limited partnership, all of whose assets and liabilities were transferred to the Company on May 27, 1971 (see Notes H and 2). The weighted average number of common and common equivalent shares outstanding for years prior to the date of acquisition reflect retroactively the shares issued in connection with the acquisition. Net earnings of this company prior to its acquisition have been transferred to Additional Paid-in Capital.

NOTE C:

Details of commission income are as follows:

Year ended	Listed	Over-the-counter	Mutual funds	Commodities	Total
May 31, 1968	$14,991,050	$2,884,241	$157,323	$115,291	$18,147,905
May 31, 1969	17,497,592	5,190,585	669,449	96,457	23,454,083
May 31, 1970	14,002,091	3,856,612	261,732	102,018	18,222,453
May 31, 1971	13,764,538	2,091,596	422,929	265,457	16,544,520
May 26, 1972	15,475,771	3,143,198	834,209	470,542	19,923,720

NOTE D:

Investment banking income is as follows:

Year ended	Underwriting management—manager	Syndicate member	Total
May 31, 1968	$ 185,087	$ 286,103	$ 471,190
May 31, 1969	3,002,414	356,860	3,359,274
May 31, 1970	1,598,406	847,783	2,446,189
May 31, 1971	69,236	1,527,662	1,596,898
May 26, 1972	2,334,849	2,856,337	5,191,186

NOTE E:

Securities owned and securities sold but not yet purchased are valued at quoted market or fair value resulting in unrealized appreciation/(depreciation), which is reflected in principal transactions for each period. The change in unrealized appreciation/(depreciation) as shown below is due not only to fluctuations in the quoted market or fair value of individual securities owned, but it is also affected by gains/(losses) realized on transactions in these securities during the period. For tax purposes securities owned are valued at cost. The change in unrealized appreciation/(depreciation) by year, the effect on net earnings and the related per share effect are as follows:

Year ended	Change in unrealized appreciation/(depreciation)	Increase/(decrease) in net earnings	
		Amount	Per share
May 31, 1968	$ 418,448	$ 301,348	$ 1.43
May 31, 1969	(507,843)	(365,343)	(1.71)
May 31, 1970	20,233	13,533	.06
May 31, 1971	319,474	214,074	.98
May 26, 1972	285,516	170,667	.73

NOTE F:

Interest income is derived from interest-bearing securities and deposits, and from credit extended to

customers for security purchases on margin and is as follows:

Year ended	Interest on margin accounts	Other	Total
May 31, 1968	$2,352,305	$26,440	$2,378,745
May 31, 1969	3,465,047	67,718	3,532,765
May 31, 1970	4,966,369	13,626	4,979,995
May 31, 1971	2,721,393	27,004	2,748,397
May 26, 1972	3,390,844	17,763	3,408,607

NOTE G:

The Company has a noncontributory profit-sharing plan, qualified under the Internal Revenue Code, which covers substantially all employees with more than one year's service. The plan is funded through a self-administered trust and may be terminated at any time by the Company. Contributions to the trust are made at the sole discretion of the Company's Board of Directors. The amount charged to income was $154,000 in 1968, $209,000 in 1969, none in 1970 and 1971, and $150,000 in 1972.

NOTE H:

The effective rate of taxes on income varies from year to year due primarily to the different tax rates applied to ordinary income and capital gains, investment tax credits, and the varying tax rates during the five-year period. The Company accounts for the investment tax credits, which amounted to $10,000 in 1968, $87,000 in 1969, none in 1970 and 1971, and $113,000 in 1972, by use of the flow-through method. State and local taxes included in taxes

on income were $77,000 in 1968, $18,000 in 1969, $70,000 in 1970, $52,000 in 1971 and $112,000 in 1972. As discussed in Notes B and 2, VCL Associates operated as a limited partnership. Pro forma provisions for taxes on income which would have been required had this business operated as a corporation are included in taxes on income in the following amounts: 1968—$2,900, 1969—$24,000, 1970—$207,800, and 1971—$2,200. These additional tax provisions reduced consolidated net earnings per share in 1968 by $.01, 1969—$.11, 1970—$.87, and 1971—$.01.

NOTE I:

Earnings per common and common equivalent share for each of the four years ended May 31, 1971 were computed by dividing net earnings by the weighted-average number of Class A voting and Class B non-voting common shares outstanding during the respective years since there were no dilutive common share equivalents outstanding during this period. For the year (52 weeks) ended May 26, 1972 the weighted-average number of common shares was increased by common share equivalents including (1) weighted-average of 6,417 shares issuable on conversion of the Class B preferred stock, (2) weighted-average of 1,360 shares issuable on conversion of the Class C preferred stock and (3) 600 shares issuable on exercise of stock options which are dilutive. All other stock options outstanding during this period are antidilutive and were excluded in computing earnings per share.

NOTE J:

No dividends have been paid by the Company.

TOUCHE ROSS & CO.

WEIS VOISIN & CO., INC.
AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET
MAY 26, 1972

ASSETS

Cash	$	1,842,307
Deposits with clearing organizations and others		753,033
Receivables from brokers and dealers (Note 3)		8,775,852
Receivables from customers (Note 3)		76,376,206
Secured demand notes of subordinated lenders (collateralized by cash of $28,206, and securities at quoted market $6,625,570) (Note 4)		4,226,794
Miscellaneous receivables (Note 9)		3,763,785
Securities owned, at quoted market or fair value (Note 5)		4,492,365
Securities held under subordination agreements, at quoted market (Note 4)		5,460,751
Exchange memberships:		
Owned—at cost (last sales prices $1,044,606)		1,289,938
Held under subordination agreements, at last sales prices (Note 4)		421,494
Leasehold improvements, office furniture and fixtures—at cost, less accumulated amortization and depreciation of $1,008,058 (Note 6)		3,513,321
Excess of investment over net assets acquired, less accumulated amortization of $76,465 (Note 2)		2,217,403
Miscellaneous other assets (Note 2)		2,396,602
		$115,529,851

See notes to consolidated financial statements

WEIS, VOISIN & CO., INC.
AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET
MAY 26, 1972

LIABILITIES AND STOCKHOLDERS' EQUITY

Short-term bank loans (Note 7)			$ 54,487,245
Payables to brokers and dealers (Note 3)			14,311,794
Payables to customers (Note 3)			16,770,379
Securities sold but not yet purchased, at quoted market (Note 5)			2,967,457
Accounts payable and accrued expenses (Note 8)			2,952,582
Due to lessors on lease contracts capitalized (Note 6)			1,475,215
Subordinated liabilities and stockholders' equity:			
Liabilities subordinated to all claims of general creditors (Note 4)	$14,977,921		
Stockholders' equity (Notes 9 and 10):			
Capital stock	2,374,800		
Additional paid-in capital	2,767,078		
Retained earnings	3,811,397		
	8,953,275		
Less treasury stock—at cost	1,366,017		
	7,587,258		22,565,179
Contingencies and commitments (Note 11)			
			$115,529,851

WEIS, VOISIN & CO., INC.

AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

	Capital stock issued							
	Number of shares							
	Common		Preferred					
	Class A par $1.00	Class B par $1.00	Class A par $100.00	Class B par $100.00	Class C par $100.00	Amount	Additional paid-in capital	Retained earnings
Balance June 1, 1969—as previously reported	144,700	150,000	14,961	—	—	$1,790,812	$ 967,778	$2,331,404
Adjustment to reflect acquisition of VCL Associates (Notes 2 and B)	—	—	—	—	—	—	(142,659)	—
Balance June 1, 1969—as adjusted	144,700	150,000	14,961	—	—	1,790,812	825,119	2,331,404
Issued	5,300	—	1,287	—	—	133,988	127,450	—
Excess of proceeds over cost of treasury stock sold:								
Common Class A 17,075 shares	—	—	—	—	—	—	344,755	—
Common Class B 40,626 shares	—	—	—	—	—	—	628,025	—
Net earnings for the year ended May 31, 1970 (Note B)	—	—	—	—	—	—	305,142	113,751
Pro forma taxes on income (Note H)	—	—	—	—	—	—	207,800	—
Balance May 31, 1970	150,000	150,000	16,248	—	—	1,924,800	2,438,291	2,445,155
Excess of proceeds over cost of treasury stock sold—common Class A 9,750 shares	—	—	—	—	—	—	82,581	—
Excess of cost over proceeds of treasury stock sold—common Class B 14,250 shares	—	—	—	—	—	—	(57,872)	—
Net earnings for the year ended May 31, 1971 (Note B)	—	—	—	—	—	—	4,721	343,968
Pro forma taxes on income (Note H)	—	—	—	—	—	—	2,200	—
Balance May 31, 1971	150,000	150,000	16,248	—	—	1,924,800	2,469,921	2,789,123
Issued	—	—	—	3,500	1,000	450,000	—	—
Excess of proceeds over cost of treasury stock sold:								
Common Class A 29,375 shares	—	—	—	—	—	—	17,827	—
Common Class B 40,750 shares	—	—	—	—	—	—	279,330	—
Net earnings for the year ended May 26, 1972	—	—	—	—	—	—	—	1,022,274
Baiance May 26, 1972	150,000	150,000	16,248	3,500	1,000	$2,374,800	$2,767,078	$3,811,397

See notes to consolidated financial statements

WEIS, VOISIN & CO., INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

	Capital stock in treasury			
	Number of shares			
	Common		Preferred	
	Class A par $1.00	Class B par $1.00	Class A par $100.00	Cost
Balance June 1, 1969 —as previously reported	47,950	41,250	4,157	$ 1,211,341
Adjustment to reflect shares issued in connection with acquisition of VCL Associates (Notes 2 and B)	—	(12,000)	—	(260,000)
Balance June 1, 1969 —as adjusted	47,950	29,250	4,157	951,341
Purchased	19,000	21,750	9,297	1,802,184
Sold	(17,075)	(40,626)	(6,945)	(1,153,493)
Balance May 31, 1970	49,875	10,374	6,509	1,600,032
Purchased	21,250	28,000	1,191	1,037,814
Sold	(9,750)	(14,250)	(1,286)	(474,917)
Balance May 31, 1971	61,375	24,124	6,414	2,162,929
Purchased	7,052	17,546	4,961	835,057
Sold	(29,375)	(40,750)	(5,400)	(1,631,969)
Balance May 26, 1972	39,052	920	5,975	$ 1,366,017

See notes to consolidated financial statements

WEIS, VOISIN & CO., INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

	Year ended		
	May 31, 1970	May 31, 1971	May 26, 1972
SOURCE OF FUNDS:			
Operations:			
Net earnings exclusive of earnings applicable to VCL Associates credited to additional paid-in capital	$ 113,751	$ 343,968	$ 1,022,274
Noncash charges—depreciation and amortization	266,497	426,422	538,410
	380,248	770,390	1,560,684
Decrease in:			
Deposits with clearing organizations and others	238,940	—	—
Receivables from brokers and dealers	7,320,413	446,876	—
Receivables from customers	5,709,490	13,543,056	—
Miscellaneous receivables	—	1,263,919	—
Securities held under subordination agreements	—	752,398	—
Exchange memberships:			
Owned	—	190,000	—
Held under subordination agreements	801,828	—	—

[CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION—(Continued)]

	Year ended		
	May 31, 1970	May 31, 1971	May 26, 1972
Increase in:			
Short-term bank loans, collateralized by customers' margin account securities	18,737,500	—	31,073,040
Short-term bank loans, collateralized by securities owned by the company or covered by subordination agreements	—	1,300,000	5,612,245
Payables to brokers and dealers	—	3,392,640	5,062,360
Payables to customers	—	—	5,642,327
Securities sold but not yet purchased	217,361	—	2,833,092
Accounts payable and accrued expenses	—	837,782	—
Due to lessors on lease contracts capitalized.	487,763	320,424	—
Liabilities subordinated to all claims of general creditors	933,576	352,089	6,474,117
Proceeds from the issue of:			
Common stock	132,750	—	—
Preferred stock	128,688	—	450,000
Proceeds from sale of treasury stock:			
Cost	1,153,493	474,917	1,631,969
Excess of proceeds over cost	972,780	24,709	297,157

[CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION—(Continued)]

	Year ended		
	May 31, 1970	May 31, 1971	May 26, 1972
Equity of VCL Associates acquired as of May 27, 1971	—	637,204	—
Other sources	—	—	61,550
	37,214,830	24,306,404	60,698,541

–10–

Page 2

APPLICATION OF FUNDS:			
Increase in:			
Deposits with clearing organizations and others	$ —	$ 154,286	$ 487,317
Receivables from brokers and dealers	—	—	4,064,603
Receivables from customers	—	—	42,799,812
Secured demand notes of subordinated lenders	—	—	4,226,794
Miscellaneous receivables	2,816,756	—	1,397,252
Securities owned	44,199	1,413,137	924,121
Securities held under subordination agreements	1,174,127	—	146,933
Exchange memberships:			
Owned	696,000	—	154,050
Held under subordination agreements	—	64,754	152,768

[CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION—(Continued)]

	Year ended		
	May 31, 1970	May 31, 1971	May 26, 1972
Miscellaneous other assets	543,416	39,862	1,750,911
Decrease in:			
Short-term bank loans, collateralized by customers' margin account securities	—	14,535,540	—
Payables to brokers and dealers	20,486,933	—	—
Payables to customers	7,985,597	5,695,133	—
Securities sold but not yet purchased	—	662,445	—
Accounts payable and accrued expenses	298,020	—	—
Purchase of leasehold improvements, furniture and fixtures	606,969	1,400,183	1,937,996
Purchase of treasury stock	1,802,184	1,037,814	835,057
Excess of investment over net assets acquired	—	—	2,217,403
	36,454,201	25,003,154	61,095,017
INCREASE/(DECREASE) IN CASH	$ 760,629	$ (696,750)	$ (396,476)

See notes to consolidated financial statements

WEIS, VOISIN & CO., INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. PRINCIPLES OF CONSOLIDATION:

The consolidated financial statements include the accounts of Weis, Voisin & Co., Inc. and all of its subsidiaries. The results of operations of companies purchased are included from the dates of acquisition. All significant intercompany balances and transactions have been eliminated in consolidation. The parent company accounts for its investments in subsidiaries by the equity method.

2. ACQUISITIONS:

Scheinman, Hochstin & Trotta, Inc.:

As of October 1, 1971, the Company acquired certain specified assets and assumed certain specified liabilities of Scheinman, Hochstin & Trotta, Inc. (SH&T), a former member firm of the New York Stock Exchange. This acquisition has been accounted for as a purchase and the excess of investment over net assets acquired of $2,293,868 is being amortized over a twenty-year period.

As part of the purchase agreement a subordinated lender of SH&T agreed to become a subordinated lender of the Company and to indemnify the Company to a maximum of $4,000,000 in the event the assumed liabilities exceeded the acquired assets. Through May 26, 1972 the liabilities assumed exceed the assets acquired by approximately $750,000 which is included in miscellaneous other assets.

Thomas J. Deegan Company, Inc.:

As of July 1, 1971, the Company acquired the outstanding capital stock of Thomas J. Deegan Company, Inc. in exchange for 3,500 shares of its 1% cumulative convertible preferred par value $100, Class B stock. The Company is accounting for this acquisition as a purchase.

VCL Associates:

As of May 27, 1971, the business and all of the assets and liabilities of VCL Associates, a limited partnership, were transferred to the Company in exchange for 12,000 shares of Class B common stock. Prior to the transfer, the Company and VCL Associates were "under common control" and the accounting for the transaction is similar to that used in a pooling of interests. The number of common shares outstanding for years prior to the date of acquisition reflect retroactively the shares issued in connection with the acquisition.

Winslow, Cohu & Stetson, Incorporated:

As of September 29, 1969, the Company acquired certain selected assets of a former New York Stock Exchange member firm, Winslow, Cohu & Stetson, Incorporated (WCS) and undertook to liquidate its assets and liabilities. This acquisition has been accounted for as a purchase. WCS assets realized and liabilities liquidated through May 26, 1972 have resulted in a net deficiency of approximately $411,000 which, in accordance with the purchase agreement, has been charged in the financial statements against the subordinated accounts ($4,315,402 at May 26, 1972) transferred from WCS. In the event that the assets realized and liabilities liquidated result ultimately in a net surplus, the Company will issue a 20-year subordinated debenture to the former stockholders of WCS in an amount equal to the net surplus.

3. RECEIVABLES FROM AND PAYABLES TO BROKERS DEALERS AND CUSTOMERS:

The components of receivables from and payables to brokers and dealers as of May 26, 1972 are as follows:

Securities failed to deliver:	
Outstanding less than 30 days	$ 5,051,188
Outstanding 30 days or more	195,682
Deposits paid for securities borrowed	2,641,600
Other	887,382
Total receivables from brokers and dealers	$ 8,775,852
Securities failed to receive:	
Outstanding less than 30 days	$ 5,386,021
Outstanding 30 days or more	256,668
Deposits received for securities losses	8,433,450
Other	235,655
Total payables to brokers and dealers	$14,311,794

"Fails" represent the contract value of securities which have not been received or delivered by settlement date.

Receivables from and payables to customers represent the dollar balances arising in connection with normal cash and margin transactions. The receivables are collateralized by securities with a quoted market of $100,306,000 held by the Company which are not reflected in the accompanying consolidated financial statements. Free credit balances totaling approximately $6,792,000 at May 26, 1972 are included in payables to customers. Accounts of officers, directors and stockholders are included in receivables from and payables to customers since they are subject to the normal terms and regulations as to payment and, in the aggregate, are not significant.

4. LIABILITIES SUBORDINATED TO ALL CLAIMS OF GENERAL CREDITORS:

Certain creditors of the Company have signed agreements subordinating their debentures, exchange memberships or securities accounts to all claims of general creditors, and thus the respective amounts are available to the Company in computing net capital under the New York Stock Exchange rule regarding capital requirements (see Note 11). These agreements generally specify release, payment, or redemption no less than six months following the date on which the lender demands termination subject to approval of the New York Stock Exchange. These liabilities at May 26, 1972 are summarized as follows:

	Rate of interest	
Debentures	7 - 10%	$ 3,110,275
Secured demand notes	8%	4,255,000
Exchange memberships	6 - 8%	421,494
Equities in securities accounts:		
Securities at quoted market	2.8 - 5%	5,460,751
Cash	4 - 10%	1,730,401
		$14,977,921

5. SECURITIES OWNED:

Securities owned at May 26, 1972 consist of the Company's regular trading and investment accounts and are summarized as follows:

		Cost
Marketable securities—at quoted market:		
U.S. Government bonds	$ 330,200	$ 332,560
Municipal bonds	175,800	162,587
Corporate debentures and notes	69,718	69,608
Corporate stocks	1,730,167	1,745,421
Arbitrage (convertible within 30 days)	1,236,572	1,151,459
	3,542,457	3,461,635
Securities not readily marketable—at fair value	949,908	508,244
	$4,492,365	$3,969,879
Marketable securities sold but not yet purchased—at quoted market:		
Corporate debentures and notes	$ 24,734	$ 24,700
Corporate stocks	1,682,327	1,671,581
Arbitrage (convertible within 30 days)	1,260,396	1,192,206
	$2,967,457	$2,888,487

Quoted market has been determined by reference to available quotations as to marketable securities. The fair values of securities not readily marketable have been determined by management. Fair values as determined are, in the aggregate, not less than cost.

The following securities included above have quoted market or fair values which exceed 5% of the balance sheet caption:

	Quoted market or fair value	Cost
Marketable securities:		
Alaska Interstate convertible debenture 6%, February 1, 1996	$404,421	$408,236
Harmony Gold Mining Ltd.	240,663	212,596
Security National Bank of Long Island	327,500	430,000
Securities not readily marketable—		
Electro-Catheter	234,983	48,330
Securities sold but not yet purchased:		
Alaska Interstate	396,250	435,239
Channel Companies, Inc.	948,500	948,500
Harmony Gold Mining Ltd. ADR	259,125	215,437
Medallion Leisure Corp.	346,000	346,000

6. LEASEHOLD IMPROVEMENTS, OFFICE FURNITURE AND FIXTURES:

Leasehold improvements, office furniture and fixtures include approximately $2,300,000 of such assets acquired under lease contracts. The net book value of these assets of approximately $1,700,000 collateralizes the amounts due to lessors on lease contracts capitalized. The Company computes depreciation and amortization by the straight-line method for financial statement purposes (see Note 8).

Maintenance and repairs are charged to expense as incurred. Renewals and betterments are capitalized. The cost of assets retired or otherwise disposed of is removed from the asset accounts and the related reserve for depreciation is removed from the reserve account; any resulting gain or loss is included in income.

7. SHORT-TERM BANK LOANS:

The Company borrows from banks primarily to finance customers' purchases on margin and dealer inventory positions. At May 26, 1972, bank borrowings of $6,912,245 were collateralized by securities owned by the Company or covered by subordination agreements having a quoted market of $12,807,000 and borrowings of $47,575,000 were collateralized by securities owned by customers having a quoted market of $71,373,000. The customer-owned securities pledged are those securities for which the Company has the right of hypothecation under signed margin agreements.

8. ACCOUNTS PAYABLE AND ACCRUED EXPENSES:

Included in accounts payable and accrued expenses are the following:

Accrued salaries and commissions	$653,000
Federal, state and local taxes on income	564,000
Interest payable on short term-bank loans and subordinated borrowings	280,000
Unclaimed dividends and interest items	218,000

Deferred income taxes of $18,000 have been provided on the difference in depreciation and amortization for leasehold improvements, office furniture and fixtures acquired since June 1, 1971, computed by the double-declining balance method for tax purposes and the straight-line method for financial reporting purposes.

9. STOCKHOLDERS' EQUITY:

The capital stock of the Company is composed of the following at May 26, 1972:

	Number of shares				
Description	Authorized	Issued	Outstanding	In treasury	Amount
Common, par value $1, Class A (voting)	150,000	150,000	110,948	39,052	$ 150,000
Common, par value $1, Class B (non-voting)	150,000	150,000	149,080	920	150,000
Preferred, par value $100, Class A	55,000	16,248	10,273	5,975	1,624,800
Preferred, par value $100, Class B, 1% cumulative, convertible	3,500	3,500	3,500	—	350,000
Preferred, par value $100, Class C, 1% cumulative, convertible	2,500	1,000	1,000	—	100,000
Preferred, par value $100, Class D, 6% cumulative	10,000	—	—	—	—
					$2,374,800

The Company has granted stock options (at opiton prices not less than fair market value as determined by the Company) to subordinated lenders to purchase Class B, nonvoting common stock which are currently exercisable as follows:

Option granted	Exercise amount	Expiration date
Shares equal to 2% of total Class A and Class B common stock issued and outstanding at the exercise date (5,200 shares at May 26, 1972)	2% of total stockholders' equity at exercise date ($29.18 per share, $151,745 total at May 26, 1972	1976
10,907 shares	$25 per share; $272,675 total	1975
2,000 shares	$17.50 per share; $35,000 total	Upon termination of subordination agreement

The exercise of these options is subject to the written approval of the New York Stock Exchange.

Subject to certain antidilution provisions, the 3,500 shares of Class B preferred stock are convertible, in whole but not in part, into 3,500 shares each of Class A and Class B common stock and the 1,000 shares of Class C preferred stock are convertible, in whole but not in part, into 2,000 shares of Class B common stock. An increase of 150,000 shares in the number of Class A and Class B common shares authorized was approved by the stockholders in June 1972.

As of May 26, 1972, $768,000 included in miscellaneous receivables in the accompanying consolidated balance sheet was due from employees in connection with the purchase of the Company's capital stock.

10. NET CAPITAL REQUIREMENTS:

The Company is required to comply with a New York Stock Exchange regulation which provides that the Company maintain a ratio of aggregate indebtedness to net capital, as defined, not exceeding 15 to 1. The excess net capital as computed under this rule was approximately $2,878,000 at May 26, 1972.

11. COMMITMENTS AND CONTINGENCIES:

There are various lawsuits pending against the Company which, in the opinion of management, will be resolved with no material adverse effect on the financial condition of the Company.

Aggregate rental commitments at May 26, 1972 under material noncancellable leases for premises were approximately $34,650,000 payable as follows:

-17-

Fiscal year Ending	Amount
May 25, 1973	$ 3,000,000
May 31, 1974	2,825,000
May 30, 1975	2,875,000
May 28, 1976	2,750,000
May 27, 1977	2,725,000
May 26, 1978-1991	20,475,000

In the normal course of business, the Company enters into underwriting commitments. Transactions relating to underwriting commitments which were open as of May 26, 1972 and subsequently settled, had no material effect on the financial statements at that date.

Defendant's Notice of Motion to Dismiss

Filed September 22, 1976

UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

[Caption omitted in printing]

PLEASE TAKE NOTICE that, upon the annexed affidavits of Arnold I. Roth (sworn to September 15, 1976), Philip H. Cohen (sworn to September 14, 1976) and Barry N. Cooper (sworn to September 14, 1976), and the complaint and the prior proceedings herein, the undersigned will move this Court, before the Honorable Inzer B. Wyatt, in Room 905, United States Court House, Foley Square, New York, New York on October 1, 1976, at 2:30 P.M., or as soon thereafter as counsel can be heard, for an order

1. Pursuant to Rule 12(b), F.R.Civ.P., dismissing this action, said complaint, and each so-called cause of action therein alleged, on the grounds that this Court lacks subject matter jurisdiction and plaintiffs have failed to state a claim upon which relief can be granted; and,

2. To the extent that the foregoing relief is not granted, staying this action pending determination of the action in the Supreme Court of the State of New York, New York County, entitled *Edward S. Redington, as Trustee for the liquidation of the business of Weis Securities, Inc., and Securities Investor Protection Corporation* v. *Touche Ross & Co.* (Index No. 13996/76); and

3. Granting to defendant such other relief as is just and proper.

September 15, 1976

ROSENMAN COLIN FREUND
LEWIS & COHEN

By /s/ ARNOLD I. ROTH
A Partner
Attorneys for Defendant
575 Madison Avenue
New York, New York 10022
212-644-7000

TO:

HUGHES HUBBARD & REED
Attorneys for Plaintiff
Edward S. Redington
One Wall Street
New York, New York 10005

HAWKINS, DELAFIELD & WOOD
Attorneys for Plaintiff
Securities Investor
Protection Corporation
67 Wall Street
New York, New York 10005

Affidavit of Arnold I. Roth in Support of Motion to Dismiss

Filed September 22, 1976

UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

[Caption omitted in printing]

STATE OF NEW YORK }
COUNTY OF NEW YORK } ss.:

ARNOLD I. ROTH, being duly sworn, deposes and says:

1. I am a member of the firm of Rosenman Colin Freund Lewis & Cohen, attorneys for defendant Touche Ross & Co. ("Touche Ross") herein. I submit this Affidavit together with the accompanying Affidavits of Philip H. Cohen and Barry N. Cooper, in support of the present motion by defendant Touche Ross for an order (i) pursuant to Rule 12(b), F.R.Civ.P., dismissing the complaint herein, each of the so-called "causes of action" therein alleged, and this action, on the grounds of lack of subject matter jurisdiction and failure to state a claim upon which relief can be granted, and (ii) to the extent that the foregoing relief is not granted, staying this action pending determination of the action in the Supreme Court of the State of New York, New York County, entitled *Edward S. Redington, as Trustee for the liquidation of the business of Weis Securities, Inc., and Securities Investors Protection Corporation* v. *Touche Ross & Co.* (Index No. 13996/76) (the "State Court Action").

2. This is yet another in the series of actions in this Court which arise from the liquidation under the Securities Investor Protection Act of 1970 ("SIPA") of the defunct brokerage firm, Weis Securities, Inc. ("Weis"), and which would impose liability upon defendant Touche Ross, a

firm of certified public accountants, by reason of its work on certain financial statements of Weis for periods ending approximately a year before the Weis collapse. This action is brought by plaintiffs Edward S. Redington ("Redington"), the Trustee for the liquidation of Weis, and Securities Investor Protection Corporation ("SIPC"), and seeks from defendant Touche Ross aggregate alleged damages of over $65,000,000.

3. Although plaintiffs seek to create the appearance of federally-created claims primarily by the now familiar tactic of alleging that the conduct of defendant Touche Ross of which they complain violated the Securities Exchange Act of 1934 (the "1934 Act"), they are here asserting what are essentially state-created, common law claims of negligence, malpractice, breach of contract and breach of warranty. Indeed, so clear is the basic common law nature of plaintiff's claims, even to plaintiffs themselves, that they did not even commence this action until almost a year after they had commenced a separate action (the "State Court Action") in the New York State courts seeking, on the basis of identical factual allegations and almost identical claims as are now asserted in the complaint in this action, the same relief against defendant Touche Ross as they now seek here.

4. The accompanying memorandum sets forth in detail the reasons which compel the granting of the present motion and the dismissal of the complaint and each of the "causes of action" therein alleged. This affidavit (and the accompanying Cohen and Cooper Affidavits) sets forth facts concerning this action and the State Court Action, and pertinent to an understanding of the many reasons why this action must be dismissed, and why plaintiffs are and should be limited to proceeding with their claims, if in fact they have any viable claims, in the State Court Action.

5. This action was commenced on April 30, 1976, by the filing of the complaint herein. A copy of the complaint is annexed hereto as Exhibit 1.

6. Almost ten months prior to the commencement of this action, by service of a summons on July 3, 1975, plaintiffs herein commenced the State Court Action in the Supreme Court of the State of New York, County of New York, under the title (which is the same as the title of this action) *Edward S. Redington, as Trustee for the liquidation of the business of Weis Securities, Inc., and Securities Investor Protection Corporation* v. *Touche Ross & Co.* (Index No. 13996/76). Copies of the summons, and the subsequently served complaint, in the State Court Action are annexed hereto as, respectively, Exhibits 2 and 3.

The parties to the State Court Action are the same as the parties to this action and the complaint in the State Court Action asserts identical factual allegations and almost identical claims, and seeks identical relief, as does the complaint in this action.

7. Defendant Touche Ross has commenced discovery in the State Court Action, having served extensive interrogatories therein on both plaintiff Redington and plaintiff SIPC and notices to take the deposition of each. Objections and answers to the interrogatories were originally due on, respectively, September 13 and September 20, and the depositions were originally set to commence on September 27 for plaintiff SIPC and on September 30 for plaintiff Redington. At plaintiffs' request, each of those dates has been adjourned for approximately one month.

8. The extensive litigation in this Court arising out of the collapse of Weis involves matters and facts pertinent to this action, among which are those set forth below.

9. The complaint herein refers (¶ 14) to the "SEC . . . action in this Court (73 Civ. 2332) against Weis and

the Weis Five for injunctive relief" an action which led to plaintiff Redington's appointment as Trustee. The complaint of the Securities and Exchange Commission (the "SEC") in that action, a copy of which is annexed hereto as Exhibit 4, alleged violations of the securities acts in connection with Weis' allegedly false financial statements *only against Weis itself and certain of its officers.* Even after the "separate investigations by the Exchange and the SEC" referred to in the complaint herein (¶ 13), the SEC complaint *did not allege that defendant Touche Ross had committed or participated in or aided and abetted any such violations.* A necessary conclusion is that the "investigations" by the SEC and the Exchange revealed that defendant Touche Ross had not committed or been involved in any violations.

10. Moreover, in the indictment filed in this Court against several former Weis officers in *United States* v. *Arthur Levine et al.* (73 Crim. 693), a copy of which is annexed hereto as Exhibit 5, Count I significantly alleged that those officers

> *"did fraudulently conceal from Weis' auditors, Touche Ross & Co., the existence and nature of the aforesaid fraudulent books and records* and, in addition, . . . *did create* directly and indirectly *wholly fictitious documentation for the aforesaid fraudulent entries"* (emphasis added) (Exh. 5, p. 5),

and three of those officers, including the former Chairman of the Board and Chief Executive Officer, the President and the Comptroller, have admitted the truth of such allegations by pleading guilty to Count I of the indictment (see copy of criminal docket sheet annexed hereto as Exhibit 6).

11. There are presently in this Court a number of actions against defendant Touche Ross which arise out of

the Weis situation. Various decisions have been rendered in those actions, and are referred to in the accompanying memorandum as pertinent.

12. In one of those actions, which was brought as a purported class action on behalf of the *customers* of Weis during the relevant period, Judge Brieant recognized that the claims against defendant Touche Ross by reason of its involvement with Weis—claims which were the same as those of plaintiffs Redington and SIPC here (indeed, claims which plaintiff SIPC purports to assert here as an alleged subrogee)—were not claims under the 1934 Act, but were at most non-federal, common law claims for negligence and malpractice which should be determined by the State courts. *Rich* v. *Touche Ross & Co.*, CCH Fed. Sec. L. Rep. ¶95,514 (S.D.N.Y. 1976). Judge Brieant held that the Rich plaintiffs did not state a claim for relief under the 1934 Act, and dismissed their second amended complaint, a copy of which is annexed hereto as Exhibit 7. Thereafter, the plaintiffs in *Rich* v. *Touche Ross & Co.*, as have other customers, commenced a State court action which is brought as a purported class action, and which is now pending in the Supreme Court of the State of New York, County of New York.

13. Another related group of such actions are the three actions in this court entitled, respectively, *Sheldon Berger et al.* v. *Weis Securities, Inc., et al.* (74 Civ. 186 (I.B.W.)), *George P. Govatos, Sr.* v. *Weis Securities, Inc., et al.* (74 Civ. 2832 (I.B.W.)) and *Irwin S. Barshack* v. *Weis Securities, Inc., et al.* (74 Civ. 2833 (I.B.W.)). Copies of the second amended complaint in the *Berger* action, and the amended complaint in the *Govatos* and *Barshack* action, are annexed hereto as, respectively, Exhibits 8 and 9.

On June 27, 1975, Judge Wyatt rendered an unreported decision on a motion by defendant Touche Ross to

dismiss the second amended complaint and amended complaint. In that decision, a copy of which is annexed hereto as Exhibit 10, Judge Wyatt granted the motion with respect to claims made under Section 17(a) of the 1934 Act (claims which were similar to those asserted in this action by plaintiffs Redington and SIPC).

14. This action involves claims based upon Section 17 of the 1934 Act and Rule 17a-5 thereunder. Because Section 17 and Rule 17a-5 have been substantially amended since the time in 1972 pertinent to this action, copies of Section 17 and Rule 17a-5 in effect at that time are annexed hereto as, respectively, Exhibits 11 and 12, for the convenience of the Court.

15. For the reasons set forth in the accompanying memorandum it is respectfully submitted that the present motion of defendant Touche Ross be granted.

/s/ ARNOLD I. ROTH

Arnold I. Roth

[Jurat omitted in printing]

Exhibit 1 to Affidavit of Arnold I. Roth:
Complaint in this Action

Exhibit 1 to the affidavit of Arnold I. Roth is the complaint and the exhibits thereto. The complaint and the exhibits thereto are printed in this appendix at pp. 5-111, *supra*.

Exhibit 2 to Affidavit of Arnold I. Roth:
Summons in State Court Action

Served July 3, 1975

SUPREME COURT OF THE
STATE OF NEW YORK
COUNTY OF NEW YORK

EDWARD S. REDINGTON, As Trustee for the Liquidation of the Business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Plaintiffs,

—against—

TOUCHE ROSS & CO.,

Defendant.

INDEX NO.

Plaintiffs designate New York County as the place of Trial

SUMMONS WITH NOTICE

Plaintiff Edward S. Redington, Trustee, resides at One Wall Street, New York, New York 10005.

Plaintiff Securities Investor Protection Corporation ("SIPC") resides at 900 Seventeenth Street, N. W., Washington, D. C. 20006.

To the above named Defendant:

YOU ARE HEREBY SUMMONED to appear in this action by serving a notice of appearance on the plaintiffs' attorneys within 20 days after the service of this summons, exclusive of the day of service.

Take notice that the object of this action is to recover damages for negligence, malpractice, fraud, breach of

contract and breach of warranty in connection with auditing and accounting services rendered by defendant to Weis Securities, Inc., and in case of your failure to appear, judgment will be taken against you by default for the sum of $55,000,000.00 on behalf of plaintiff Edward S. Redington, Trustee, and for the sum of $14,500,000.00 on behalf of plaintiff SIPC, plus interest from July 7, 1972 and the costs and disbursements of this action.

The basis of the venue designated is the residence of the defendant, which is 1633 Broadway, New York, New York 10019.

Dated: July 2, 1975

HUGHES HUBBARD & REED
Attorneys for Trustee
One Wall Street
New York, New York 10005
(212) 943-6500

WILFRED R. CARON, ESQ.
Attorney for SIPC
c/o Goldman & Drazen
One State Street Plaza
New York, New York 10004
(212) 422-0488

Exhibit 3 to Affidavit of Arnold I. Roth:
Complaint in State Court Action
Served May 3, 1976

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Plaintiffs,

—against—

TOUCHE ROSS & CO.,

Defendant.

COMPLAINT

Index No.

Plaintiffs, EDWARD S. REDINGTON, Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION, by their respective attorneys, complaining of the Defendant, allege upon information and belief, except as to paragraphs 1, 2, 4, 9, 10 and 17 hereof, as follows:

PARTIES

1. Plaintiff Edward S. Redington (the "Trustee") was duly appointed by Order of the United States District Court for the Southern District of New York dated May 30, 1973 as Trustee for the liquidation of the business of Weis Securities, Inc. ("Weis") pursuant to the Securities

Investor Protection Act of 1970 (15 U.S.C. Section 78aaa, *et seq.*) (hereinafter the "1970 Act"), has duly qualified, and is presently acting in such capacity.

2. Plaintiff Securities Investor Protection Corporation ("SIPC") is a non-profit membership corporation created by and organized under the 1970 Act whose members are, with certain statutory exceptions, all persons registered as broker-dealers under the Securities Exchange Act of 1934 (15 U.S.C. Section 78a, *et seq.*) (hereinafter the "1934 Act") and, with certain statutory exceptions, all persons who are members of a national securities exchange. The duties and functions of SIPC are set forth in the 1970 Act and include, *inter alia*, the initiation of liquidation proceedings against members of SIPC that have failed or are in danger of failing to meet their obligations to customers, the establishment of a fund from which to satisfy, within certain limits, the claims of customers of SIPC members that are being liquidated pursuant to the 1970 Act, and—in consultation with and with the cooperation of the Securities and Exchange Commission ("SEC"), the New York Stock Exchange, Inc. (the "Exchange") and other self-regulatory organizations—the establishment of procedures designed to detect approaching financial difficulty of SIPC members and to ensure that such members are in compliance with applicable financial responsibility rules. SIPC relies entirely and solely on the SEC, the Exchange and other self-regulatory organizations to monitor the financial condition of SIPC members, to investigate any SIPC member in financial difficulty, and to notify SIPC thereof. At all relevant times Weis was a member of SIPC.

3. Defendant Touche Ross & Co. ("Touche Ross") is a partnership of certified public accountants with its principal place of business at 1633 Broadway in the City,

County and State of New York. In or about 1969, Touche Ross was engaged by Weis as its independent certified public accounting firm, and Touche Ross continued to act in such capacity from about 1969 until about May 1973, when the forced liquidation of Weis commenced.

COMMON ALLEGATIONS

4. At all relevant times prior to May 30, 1973, Weis was a corporation registered as a broker-dealer with the SEC and was engaged in the business of a broker-dealer of securities. From June 1965 until May 1973, Weis was a member of the Exchange, the self-regulatory organization designated by SIPC to examine Weis for compliance with the applicable financial responsibility rules imposed on broker-dealers pursuant to Section 6 of the 1934 Act (15 U.S.C. Section 78f) for the protection of the public as a minimum prerequisite for conducting a business as a broker-dealer in securities.

5. For each of its four fiscal years 1968 through 1971 (ended May 31), Weis' audited financial statements reflected a profit. During early 1972 five of Weis' officers (the "Weis Five") became increasingly concerned that a fair and accurate presentation of Weis' results of operations for fiscal year 1972 would reflect that Weis was operating at a loss. The Weis Five misstated the financial condition and results of operations of Weis in financial reports prepared at fiscal year-end 1972. These reports were required to be filed with regulatory authorities pursuant to Section 17 of the 1934 Act (15 U.S.C. Section 78q) and were directly or indirectly submitted to Weis, its Board of Directors, the SEC, SIPC, the Exchange, and Weis' customers, creditors, lenders and shareholders. Such misstatements were accomplished by, *inter alia*, materially overstating assets, creating non-existent assets, understating liabilities, overstating income, and under-

stating expenses. The purpose and effect of such material misstatements were, *inter alia,* to create a false impression that Weis' earnings for the fiscal year ended May 26, 1972 were $1,700,000 before taxes whereas in truth and in fact Weis had actually suffered losses in that period in excess of $1,500,000.

6. Had Weis' actual financial condition, its actual results of operations, and the misstatement in its books and records been truthfully reported at the end of Weis' 1972 fiscal year, Weis' 1973 forced liquidation under the 1970 Act would not have become necessary, and most if not all of Weis' assets and its good will as a going concern could have been preserved by a number of means including, *inter alia,* change in Weis' management, reversal of its policy of growth and expansion, curtailment or contraction of certain of its operations and business practices, gradual liquidation of some or all of its operations, or merger with another securities firm. Moreover, if a liquidation of Weis had been necessary as the result of such truthful reporting, such liquidation could have occurred at the end of Weis' 1972 fiscal year, when its assets were greater and the aggregate of its liabilities was lower than a year later.

7. The incorrect and incomplete fiscal 1972 year-end reports prepared by and under the direction of the Weis Five were certified by Touche Ross as being correct and complete. Consequently, the doctoring of Weis' books, records and required reports, the deterioration of its financial condition and the violations of financial responsibility rules could not be nipped in the bud at a time when a forced liquidation of Weis could still have been avoided. Instead, during Weis' fiscal year 1973, Weis' financial condition deteriorated as the Weis policy of expansion continued unabated. Weis incurred substantial operating losses, depletion of its assets, and depletion of the property

held by Weis in trust for its customers. The Weis Five continued to make false and fictitious entries in Weis' books and records and continued, directly or indirectly, to submit false reports to Weis, its Board of Directors, the SEC, SIPC, the Exchange, and Weis' customers, creditors, lenders and shareholders in order to conceal Weis' true financial condition.

8. Not until April and May of 1973, as a result of separate investigations by the Exchange and the SEC, did the misstatement of Weis' financial condition come to light. These investigations gradually revealed the violations of financial responsibility rules, Weis' unsafe, unsatisfactory and deteriorating financial condition, and the lack of accuracy and reliability of any of its financial statements, including those certified by Touche Ross. These revelations and the resulting uncertainties with respect to Weis' true financial condition prevented Weis from being saved as a going concern or being merged with another, financially more secure, brokerage firm, and resulted in Weis' forced liquidation under the 1970 Act.

9. On May 24, 1973, in the United States District Court for the Southern District of New York, the SEC commenced an action against Weis and the Weis Five for injunctive relief to prevent them from conducting a brokerage business in violation of the 1934 Act and the rules and regulations promulgated thereunder. Also on May 24, 1973 (the "Filing Date"), pursuant to Section 5(a)(2) of the 1970 Act (15 U.S.C. Section 78eee(a)(2)), SIPC applied in the same Court for a decree adjudicating that the customers of Weis were in need of the protection of the 1970 Act. On May 30, 1973 (the "Date of Adjudication") such a decree was granted, the liquidation of Weis was ordered, and Plaintiff Edward S. Redington was appointed Trustee for the liquidation of the business of Weis.

10. Upon the entry of the decree referred to in the preceding paragraph, SIPC was required by the 1970 Act to provide, and did provide to the Trustee, funds for the payment of claims submitted by certain customers and creditors of Weis and for certain administrative expenses of the liquidation.

11. At all relevant times, Defendant Touche Ross held itself out to Weis, the SEC, SIPC, the Exchange and the general public as possessing the ordinary skill, ability and expertise of certified public accountants in accounting and auditing matters, and as being qualified, *inter alia,* (i) to examine and audit the books, records and accounts of firms engaged in the securities business in accordance with generally accepted auditing standards and (ii) to express opinions with respect to the financial statements of such firms as fairly reflecting their financial condition and results of operations in accordance with generally accepted accounting principles. Touche Ross further held itself out as being familiar with accounting and auditing practices and standards required by the SEC and the Exchange for firms engaged in the securities business.

12. From approximately 1969 until the Date of Adjudication, Touche Ross was engaged by Weis for valuable consideration to serve as Weis' independent certified public accounting firm. During this period Touche Ross agreed to conduct annual audits of the affairs of Weis and to issue opinions and prepare reports on its financial statements, all in accordance with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the SEC and the Exchange. In accepting said engagement, Touche Ross agreed to perform said services in a thorough, proper, skillful and diligent manner.

13. Weis and its Board of Directors, customers, creditors, lenders and shareholders, and the SEC, the

Exchange and SIPC relied on Touche Ross to apply the standards and expertise to express the opinions, to make the certifications and to prepare or assist in the preparation of the reports discussed in paragraphs 11 and 12, *supra,* for the purposes, among others, of (i) protecting Weis from fraudulent activity of its officers, directors, agents, and employees; (ii) safeguarding the existence and use of Weis' assets; (iii) assuring the accuracy of financial data submitted directly or indirectly to the Exchange, the SEC and SIPC, and generally made available to the public; (iv) determining whether Weis could continue to engage in business as a broker-dealer in securities; (v) determining whether or not significant restrictions and alterations in the scope and nature of its operations would be required in order for Weis to continue to engage in business as a broker-dealer; and (vi) making informed business decisions concerning the future operations of Weis on the basis of accurate financial information.

14. In or about late 1971 or early 1972, Touche Ross agreed with Weis to perform the aforementioned auditing and accounting services for the year 1972. Among other things, Touche Ross agreed (a) to prepare, cause to be prepared, and assist in the preparation of financial statements of Weis and to issue opinion letters with respect to said statements; (b) to audit the affairs of Weis in accordance with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations promulgated by the Exchange and the SEC pursuant to Sections 6 and 17 of the 1934 Act (15 U.S.C. Sections 78f and 78q); (c) to notify the Exchange promptly that such audit had been commenced; (d) to prepare an answer to the financial questionnaire (the "Answers to the Financial Questionnaire") of the Exchange based upon said audit; (e) to submit to the

Exchange (i) a copy of the Answers to the Financial Questionnaire, (ii) an attestation that the requirements of the audit regulations had been observed in the conduct of the audit, and (iii) a statement that Touche Ross had made a review of Weis' accounting system, internal accounting control and procedures for safeguarding securities; (f) to furnish to the Exchange comments relative to any material inadequacies found to exist in Weis' accounting system, internal accounting control, and procedures for safeguarding securities; and (g) to indicate any corrective action taken or proposed.

15. Weis' employment of Touche Ross as its independent certified public accounting firm was not merely a matter of private contract between Weis and Touche Ross, but was required by the Exchange pursuant to its duty under Section 6 of the 1934 Act (15 U.S.C. Section 78f) to regulate its members' conduct of their businesses and supervise their financial condition for the benefit of the public. Touche Ross knew or should have known that Weis' engagement of an independent certified public accounting firm was a requirement of the Exchange and that it was for the benefit both of Weis in making decisions with respect to the operation of its business and of persons other than Weis.

16. In accordance with its engagement agreement, Touche Ross purported to conduct an audit of Weis' books and records for the fiscal year ended May 26, 1972 and in connection therewith (a) certified, prepared, caused to be prepared, and assisted in the preparation of financial statements of Weis; (b) prepared and certified Weis' Answers to the Financial Questionnaire; and (c) issued four opinion letters (the "1972 Opinion Letters") to the Board of Directors of Weis dated, respectively, July 7, 1972, July 7, 1972, July 21, 1972 and July 21, 1972.

17. By means of the foregoing, Touche Ross represented and certified that it had examined (i) the statement of Weis' financial condition as of May 26, 1972, (ii) Weis' Answers to the Financial Questionnaire as of May 26, 1972, (iii) Weis' consolidated balance sheet for the 52 weeks ended May 26, 1972, and (iv) Weis' consolidated statement of earnings for the five years ended May 26, 1972. The letter pertaining to the Answers to the Financial Questionnaire stated that the Touche Ross examination had been made "in accordance with generally accepted auditing standards, and accordingly included a review of the accounting system, internal accounting control and the procedures for safeguarding securities including such tests thereof . . . as [Touche Ross] considered necessary in the circumstances, including the audit procedures prescribed by the New York Stock Exchange and the Securities and Exchange Commission." The letter also stated that the Answers to the Financial Questionnaire presented fairly the financial position of Weis at May 26, 1972 in the form prescribed by the Exchange and the SEC in conformity with generally accepted accounting principles applied on a consistent basis. Each of the other three 1972 Opinion Letters stated that the Touche Ross examination had been conducted in accordance with generally accepted auditing standards and that the aforementioned financial statements presented fairly the financial position of Weis and subsidiaries at May 26, 1972, and the results of operations and changes in their financial position for the year and the five years then ended in conformity with generally accepted accounting principles applied on a consistent basis. (The 1972 Opinion Letters and accompanying Answers to the Financial Questionnaire and financial statements are annexed hereto as Exhibits A, B, C and D.)

18. Touche Ross knew, should have known and intended that Weis and its Board of Directors would rely

on the 1972 Opinion Letters and accompanying Answers to the Financial Questionnaire and financial statements for various purposes, including those set forth in paragraph 13, *supra*.

19. Touche Ross knew, should have known and intended that the SEC, the Exchange and SIPC would rely on the 1972 Opinion Letters and accompanying Answers to the Financial Questionnaire and financial statements in carrying out their respective regulatory, supervisory and protective duties with respect to Weis, in determining whether Weis was in compliance with the applicable financial responsibility rules, and in determining whether Weis was in financial difficulty.

20. Touche Ross knew, should have known and intended that Weis' customers, creditors, lenders and shareholders would rely directly or indirectly on the 1972 Opinion Letters and accompanying Answers to the Financial Questionnaire and financial statements in making decisions whether to commence or continue their respective relationships with Weis.

21. Touche Ross breached and failed to perform its agreement and obligation to render auditing and accounting services with respect to Weis in a thorough, proper, skillful and diligent manner and performed said services in a negligent, reckless, careless, unskilled and grossly negligent manner in that, among other things, it:

a. failed to audit, verify and examine the books, records, accounts and financial statements of Weis in accordance with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and the SEC;

b. failed to prepare, cause to be prepared, and assist in the preparation of accurate financial statements of Weis and Weis' Answers to the Financial Questionnaire;

c. rendered the 1972 Opinion Letters, which were false, inaccurate and incomplete;

d. failed properly to test, study and evaluate Weis' system of internal accounting control;

e. failed to obtain competent evidential matter sufficient to afford a proper basis for the 1972 Opinion Letters;

f. falsely certified that it had examined Weis' books and records in accordance with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and the SEC; and

g. failed to inform or otherwise alert Weis, its Board of Directors, the SEC and the Exchange (and, through the Exchange, SIPC) (i) of the material errors in Weis' Answers to the Financial Questionnaire and in Weis' financial statements prepared in connection with the 1972 Touche Ross audit; (ii) of the existence of inaccurate and unreliable books and records with respect to Weis; or (iii) of the possibility that Weis was facing financial difficulty.

22. Specifically, among other things, Touche Ross failed properly to audit, verify and examine:

(a) the Scheinman Hochstin & Trotta liquidation omnibus account (the "SH&T Omnibus Account"), a claimed asset of $745,000. If Touche Ross had audited, verified and examined the SH&T Omnibus Account in accordance with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and the SEC, it would have discovered the following:

(1) that in or about April 1972 the SH&T Omnibus Account had been debited in the amount of approximately $625,000;

(2) that, contrary to generally accepted accounting principles, the offsetting credits for this debit were to one or more income accounts;

(3) that the purpose and effect of these improper credits were to overstate Weis' gross income by approximately $625,000 and its net income and net worth by approximately $312,500; and

(4) that an overstatement by this amount was a material overstatement because it constituted over 30% of Weis' claimed net income for the entire fiscal year ended May 26, 1972 and over 4% of Weis' claimed net worth as of that date.

(b) the Winslow, Cohu & Stetson ("WC&S") insurance claim receivable, a claimed asset of $1,285,000. If Touche Ross had audited, verified and examined the WC&S insurance claim receivable in accordance with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and the SEC, it would have discovered the following:

(1) that, on or about May 8, 1972, the WC&S insurance claim receivable had improperly been increased in value (debited) to $785,000 because of interest purportedly payable on the claim;

(2) that, on or about May 25, 1972, the WC&S insurance claim receivable had improperly been further increased in value (debited) to $1,285,000 because of a purported increase in the value of the claim;

(3) that, contrary to generally accepted accounting principles, the offsetting credits for these two debits had been made to various income accounts;

(4) that the purpose and effect of these improper transactions were to overstate Weis' gross income by approximately $685,000 and its net income and net worth by approximately $342,500;

(5) that an overstatement by this amount was a material overstatement because it constituted nearly 35% of Weis' claimed net income for the entire fiscal year ended May 26, 1972 and approximately 4.5% of Weis' claimed net worth as of that date.

(c) other false, fraudulent and improper entries, irregularities and accounting transactions in the books of Weis which included, *inter alia,* the following:

(1) The re-depositing into income accounts of at least $800,000 worth of checks which were purportedly drawn to pay vendors or other creditors, thus overstating Weis' net income and net worth by at least $400,000;

(2) The doubling (to approximately $432,000) of accrued commission income for May 22-26, 1972, thus overstating Weis' net income, net worth, and net capital by approximately $108,000;

(3) The improper crediting of income accounts with proceeds from a sale-leaseback transaction, thus overstating Weis' net income and net worth;

(4) The improper transfer of certain short security positions to dividend receivable accounts;

(5) The improper failure to record certain liabilities of Weis on the books of Weis;

(6) The manipulation of certain error accounts to reflect false credit balances of $100,000 to $200,000, which then were taken into income, thus overstating Weis' net income, net worth and net capital by approximately $50,000 to $100,000;

(7) The improper designation of up to $500,000 worth of miscellaneous receivables as "current" so that it was not necessary to deduct them from capital in computing Weis' net capital ratio under Exchange Rule 325, with the result that Weis' net capital ratio was made to appear to be below 10:1 and Weis thus was not precluded by Exchange Rule 326 from expanding its business.

23. Upon the discovery by Touche Ross of any one or more of the false entries or improper accounting transactions discussed in paragraph 22 above, Touche Ross would have had an obligation to report such discoveries, *inter alia,* to Weis, its Board of Directors, the SEC and the Exchange (and, through the Exchange, SIPC); and it would have had an obligation to report such discoveries in the 1972 Opinion Letters and to refrain from issuing the 1972 Opinion Letters in the form they actually took.

24. As a direct and proximate result of Touche Ross' failure to conduct the 1972 audit of Weis in accordance with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and the SEC:

a. the acts of the Weis Five as set forth in paragraphs 5 through 8 herein were not promptly discovered, and the Weis Five were able to continue to make false and fictitious entries in Weis' books, records and financial statements;

b. other misstatements and inaccuracies in Weis' books, records and financial statements were not discovered;

c. Weis, its Board of Directors, the Exchange, the SEC, SIPC, and Weis' customers, creditors, lenders and

shareholders were misled by Touche Ross into believing or assuming that as of May 26, 1972 Weis was in sound financial condition and in compliance with applicable financial responsibility rules;

d. Weis, its Board of Directors, the Exchange, the SEC and SIPC were prevented from (i) knowing the true financial condition of Weis, (ii) performing their respective duties to safeguard the assets of Weis and the property Weis was holding in trust for its customers, (iii) taking and causing to be taken appropriate and immediate remedial action at a time when a forced liquidation of Weis under the 1970 Act could have been prevented, and (iv) taking or causing to be taken appropriate and immediate action to avoid or reduce the costs of satisfying the claims of Weis' customers;

e. the acts of the Weis Five as set forth in paragraphs 5 through 8 herein were not discovered by Weis, its Board of Directors, the SEC, SIPC or the Exchange until April and May 1973 at which time the only remedial action that could be taken was the forced liquidation of Weis under the 1970 Act, which caused and continues to cause substantial injury to Weis and SIPC as well as Weis' customers, creditors, lenders and shareholders;

f. the assets of Weis and the property Weis was holding in trust for its customers were not on the Filing Date or thereafter sufficient to satisfy the claims of Weis' customers, creditors, lenders and shareholders;

g. Weis was unable to comply with the minimum financial responsibility rules which would allow it to conduct its business as a broker-dealer in securities, was unable to restore itself to a condition in which it could remain in business, and lost the value of its business and assets as a going concern;

h. the assets of Weis were wasted and mismanaged; and

i. Weis was caused to undertake financial obligations which it could not satisfy and which it would not or could not have undertaken had its true financial condition as of May 26, 1972 been known to Weis and its Board of Directors, the SEC, the Exchange and SIPC.

As and For Plaintiff Trustee's First Cause of Action

25. Plaintiff Trustee repeats and realleges each and every allegation contained in paragraphs 1 through 24 herein as though here set forth in full.

26. As a result of the negligence and malpractice of Touche Ross, including that set forth in paragraphs 21 through 23 herein, and not as the result of any negligence of the Trustee or Weis, Weis has suffered and will continue to suffer damages in an amount which is presently estimated to be at least $51,000,000.

As and For Plaintiff Trustee's Second Cause of Action

27. Plaintiff Trustee repeats and realleges each and every allegation contained in paragraphs 1 through 24 herein as though here set forth in full.

28. Touche Ross violated and aided and abetted the Weis Five's violation of a statute (Section 17 of the 1934 Act (15 U.S.C. Section 78q)), the purpose of which was to protect a class of persons that included Weis, its customers, creditors, lenders and shareholders from the types of injuries that they respectively and collectively have suffered on account of the forced liquidation of Weis.

29. As a result of Touche Ross' negligence per se, and not as the result of any negligence of the Trustee or Weis, Weis has suffered and will continue to suffer damages in an amount which is presently estimated to be at least $51,000,000.

As and for Plaintiff Trustee's Third Cause of Action

30. Plaintiff Trustee repeats and realleges each and every allegation contained in paragraphs 1 through 24 herein as though here set forth in full.

31. The auditing and accounting services performed by Touche Ross with respect to Weis were performed in so reckless and grossly negligent a manner that Touche Ross knew or should have known that the 1972 Opinion Letters and the accompanying Answers to the Financial Questionnaire and financial statements were false, inaccurate and incomplete.

32. By reason of the foregoing reckless and grossly negligent conduct of Touche Ross, and not as the result of any negligence of the Trustee or Weis, Weis has suffered and will continue to suffer damages in an amount which is presently estimated to be at least $51,000,000.

As and for Plaintiff Trustee's Fourth Cause of Action

33. Plaintiff Trustee repeats and realleges each and every allegation contained in paragraphs 1 through 24 herein as though here set forth in full.

34. In connection with the auditing and accounting services performed by Touche Ross and as compensation therefor Weis paid Touche Ross a certain sum of money (the "Touche Ross Fee"), the amount of which is not presently known to Plaintiff Trustee.

35. By reason of Touche Ross' breach of and failure to perform its agreement to render said auditing and accounting services in a thorough, proper, skillful and diligent manner, as set forth in paragraphs 21 through 23 herein, Weis is entitled to general damages in the amount of the Touche Ross Fee and to consequential damages in an amount which is presently estimated to be at least $51,000,000.

As and for Plaintiff Trustee's Fifth Cause of Action

36. Plaintiff Trustee repeats and realleges each and every allegation contained in paragraphs 1 through 24 herein as though here set forth in full.

37. In its engagement letter with Weis and other communications to Weis, Touche Ross expressly and impliedly warranted to Weis that its services to Weis would be of a certain quality (i.e. that, *inter alia,* they would comply with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and the SEC).

38. By reason of the breaches and failures of Touche Ross, including those set forth in paragraphs 21 through 23 herein, those services were not of the warranted quality and were wholly without value to Weis.

39. By reason of Touche Ross' breach of warranty of the quality of its services to Weis, Weis is entitled to general damages in the amount of the difference between the actual and warranted values of the services rendered, and to consequential damages in an amount which is presently estimated to be at least $51,000,000.

As and for Plaintiff SIPC's First Cause of Action

40. Plaintiff SIPC repeats and realleges each and every allegation contained in paragraphs 1 through 24 herein as though here set forth in full.

41. As a consequence of the liquidation of Weis, SIPC was required to satisfy the claims of over 34,000 customers and certain other creditors of Weis and to pay for certain administrative expenses of the liquidation.

42. As a result of the negligence and malpractice of Touche Ross, including that set forth in paragraphs 21 through 23 herein, and not as a result of any negligence of SIPC, SIPC has suffered and will continue to suffer damages in an amount which is presently estimated to be at least $14,000,000.

As and for Plaintiff SIPC's Second Cause of Action

43. Plaintiff SIPC repeats and realleges each and every allegation contained in paragraphs 1 through 24 herein as though here set forth in full.

44. As a consequence of the liquidation of Weis, SIPC was required to satisfy the claims of over 34,000 customers and certain other creditors of Weis and to pay for certain administrative expenses of the liquidation.

45. As a result of the malpractice of Touche Ross and its breach of the duties it owed to SIPC (and not as a result of any negligence of SIPC), in that the auditing and accounting services performed by Touche Ross were conducted in so reckless and grossly negligent a manner that Touche Ross knew or should have known that the 1972 Opinion Letters and the accompanying Answers to the Financial Questionnaire and financial statements were

false, inaccurate and incomplete, SIPC has suffered and will continue to suffer damages in an amount which is presently estimated to be at least $14,000,000.

As and for Plaintiff SIPC's Third Cause of Action

46. Plaintiff SIPC repeats and realleges each and every allegation contained in paragraphs 1 through 24 herein as though here set forth in full.

47. As a result of the negligence and malpractice of Touche Ross, including that set forth in paragraphs 21 through 23 herein, and not as a result of any negligence of any customer or creditor of Weis, the customers and certain other creditors of Weis were misled into believing or assuming that Weis was not in financial difficulty, and consequently over 34,000 of said customers and creditors ultimately filed claims in the Weis liquidation proceeding.

48. The SIPC fund has been or may be depleted in order to satisfy the claims of the over 34,000 customers and creditors of Weis, hereinabove mentioned in paragraph 47, and to pay for certain administrative expenses of the liquidation.

49. But for Touche Ross' negligence and malpractice, the SIPC fund would not have been depleted to the extent that it has been, if at all, and consequently SIPC is subrogated to those claims which such customers and certain other creditors of Weis who have been paid out of the SIPC fund could have asserted against Touche Ross based on the auditing and accounting services it performed with respect to Weis.

50. The aggregate of the claims of Weis' customers and certain other creditors which have been satisfied out of the SIPC fund and for which Touche Ross is liable to SIPC is presently estimated to be at least $14,000,000.

As and for Plaintiff SIPC's Fourth Cause of Action

51. Plaintiff SIPC repeats and realleges each and every allegation contained in paragraphs 1 through 24 herein as though here set forth in full.

52. As a result of the malpractice of Touche Ross and its breach of the duties it owed to the customers and certain other creditors of Weis (and not as a result of any negligence of any customer or creditor of Weis), in that the auditing and accounting services performed by Touche Ross were conducted in so reckless and grossly negligent a manner that Touche Ross knew or should have known that the 1972 Opinion Letters and the accompanying Answers to the Financial Questionnaire and financial statements were false, inaccurate and incomplete, the customers and certain other creditors of Weis were misled into believing or assuming that Weis was not in financial difficulty, and consequently over 34,000 of said customers and creditors ultimately filed claims in the Weis liquidation proceeding.

53. The SIPC fund has been or may be depleted in order to satisfy the claims of the over 34,000 customers and creditors of Weis, hereinabove mentioned in paragraph 52, and to pay for certain administrative expenses of the liquidation.

54. But for Touche Ross' malpractice, recklessness and gross negligence, the SIPC fund would not have been depleted to the extent that it has been, if at all, and consequently SIPC is subrogated to any and all claims which such customers and certain other creditors of Weis who have been paid out of the SIPC fund could have asserted against Touche Ross based on the auditing and accounting services it performed with respect to Weis.

55. The aggregate of the claims of Weis' customers and certain other creditors which have been satisfied out of the SIPC fund and for which Touche Ross is liable to SIPC is presently estimated to be at least $14,000,000.

WHEREFORE, plaintiffs demand judgment:

a. for $51,000,000 on Plaintiff Trustee's First Cause of Action;

b. for $51,000,000 on Plaintiff Trustee's Second Cause of Action;

c. for $51,000,000 on Plaintiff Trustee's Third Cause of Action;

d. for the amount of the Touche Ross Fee plus $51,000,000 on Plaintiff Trustee's Fourth Cause of Action;

e. for an amount which is the difference between the actual and warranted values of Touche Ross' services with respect to Weis, plus $51,000,000, on Plaintiff Trustee's Fifth Cause of Action;

f. for $14,000,000 on Plaintiff SIPC's First Cause of Action;

g. for $14,000,000 on Plaintiff SIPC's Second Cause of Action;

h. for $14,000,000 on Plaintiff SIPC's Third Cause of Action;

i. for $14,000,000 on Plaintiff SIPC's Fourth Cause of Action;

j. for interest on the amounts demanded herein;

k. for the costs and disbursements of this action; and

l. for such other, further and different relief as to the Court may seem just and proper.

Dated: New York, New York
May 3, 1976

HUGHES HUBBARD & REED
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[Exhibits A, B, C and D to the Complaint in the State Court Action are the same as Exhibits A, B, C and D to the Complaint in this action, which are printed in this appendix at pp. 35-111, *supra.*]

[Exhibit 4 through Exhibit 12 to the Affidavit of Arnold I. Roth omitted in printing]

Affidavit of Wilfred R. Caron in Opposition to Motion to Dismiss

Filed January 10, 1977

UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

[Caption omitted in printing]

District of Columbia: ss.

WILFRED R. CARON, being duly sworn, deposes and says:

1. Deponent is the Associate General Counsel of plaintiff Securities Investor Protection Corporation ("SIPC") and is familiar with the prior proceedings herein, in particular the motion of the defendant Touche Ross & Co. ("Touche Ross") pursuant to Rule 12 of the Federal Rules of Civil Procedure to dismiss SIPC's complaint for alleged legal insufficiency and jurisdictional reasons. This affidavit is respectfully submitted in opposition to that motion.

2. Deponent is informed by SIPC's attorneys of record that Touche Ross' engagements in proceedings under the Securities Investor Protection Act of 1970 ("SIPA") may be relevant to certain aspects of Touche Ross' aforesaid motion, particularly insofar as those engagements indicate Touche Ross' awareness of its obligations to SIPC and of SIPC's structure, functions and objectives. The purpose of this affidavit, therefore, is to set forth certain general information relating to that subject.

3. To date, pursuant to section 6(b)(1)(A) of SIPA Touche Ross has been engaged as the accounting firm by various trustees in eight proceedings under SIPA. Of

these, five were commenced prior to the completion of Touche Ross' audit of Weis Securities, Inc. which is the subject of this action ("Weis Audit").

TOUCHE ROSS' ENGAGEMENT IN SIPA PROCEEDINGS IN THE SOUTHERN DISTRICT OF NEW YORK

4. Before and during the Weis Audit, Touche Ross was involved in two SIPA proceedings in the Southern District of New York, namely, the liquidation of J. R. Radin & Co., Inc. ("Radin") and Kenneth Bove & Co. ("Bove"). The *Radin* proceeding was commenced by SIPC on March 9, 1972 and the *Bove* proceeding was commenced by SIPC on May 25, 1972.

5. In the *Radin* proceeding, the trustee appointed for the liquidation of Radin was William W. Golub, Esq., a member of the law firm Rosenman, Colin, Freund, Lewis & Cohen (the "Rosenman Firm") which also represents Touche Ross in this action. Mr. Golub was appointed on March 9, 1972. With SIPC's approval, Mr. Golub retained Touche Ross as his accountants for the purpose of that proceeding. Annexed hereto are copies of (i) Touche Ross' letter to Mr. Golub dated March 14, 1972 referring to its engagement retention by Mr. Golub, and (ii) Mr. Golub's letter to SIPC dated March 17, 1972 requesting SIPC's authorization to retain Touche Ross as his accountants. These letters are respectively designated Exhibits A and B.

6. In the *Bove* proceedings, Mr. Golub was first appointed as temporary receiver on May 25, 1972, and on August 17, 1972 as liquidating trustee. In his capacity as temporary receiver, Mr. Golub engaged Touche Ross as his accountants, and that engagement continued after his appointment as trustee. Annexed hereto as Exhibit C is a copy of a revised invoice dated August 3, 1972 submitted by Touche Ross to Mr. Golub for services rendered during

the month of May 1972. There were numerous other invoices but this particular one establishes that Touche Ross was actively engaged on Mr. Golub's behalf while the Weis Audit was in progress.

7. Deponent is informed by SIPC's Finance Department that the following Touche Ross personnel were engaged on Mr. Golub's behalf in one or more of the capacities indicated in the cases specified:

Name	Capacity	Radin	Bove
Louis Haag	Partner		X
Karl Brunhuber	Manager	X	X
John Burkhardt	Manager		X
Stuart Newman	Manager	X	
Irwin Goldberg	Manager	X	
Joseph Puglisi	Supervisor	X	
Mark Berlin	Supervisor		X
Robert Gubitosi	Senior	X	X
Thomas Hogan	Senior		X
James Reilly	Senior	X	
James Blow	Assistant		X
James Buck	Assistant		X
Bruce Price	Assistant		X
Vincent Criscillo	Assistant	X	

Touche Ross' answers to the plaintiffs' interrogatories dated July 23, 1976 (Answer to Interrogatory No. 2) identify each of the foregoing as persons in Touche Ross' employ who were engaged in the Weis Audit.

8. The Rosenman Firm served as counsel to Mr. Golub in both the *Radin* and *Bove* cases.

Other SIPA Proceedings In Which Touche Ross Was Engaged

9. Touche Ross' engagement in SIPA proceedings antedates its engagement in the *Radin* and *Bove* matters, as illustrated by the following.

10. *Carl Berglund d/b/a Colonial Investment Securities ("Colonial")*. In the *Colonial* matter, the trustee was appointed on August 6, 1971 by the U.S. District Court for the District of Massachusetts. Annexed hereto as Exhibit D is a copy of Touche Ross' letter to SIPC's General Counsel dated August 11, 1971 wherein it requested approval of its engagement as the trustee's accountant.

11. *John Edward & Co. Inc. ("Edward")*. In the *Edward* matter, the trustee was appointed on July 1, 1971 by the U.S. District Court for the District of Massachusetts. Annexed hereto are copies of (i) Touche Ross' letter to the trustee dated September 1, 1971 concerning its engagement by the trustee, (ii) a letter from the trustee's attorneys to SIPC dated September 2, 1971 requesting SIPC's approval of the trustee's engagement of Touche Ross, and (iii) SIPC's letter (by L. W. McChesney) to the trustee's attorneys dated September 7, 1971 which approved Touche Ross' engagement. These are designated as Exhibits E, F, and G.

12. *C. H. Wagner & Co. Inc. ("Wagner")*. In the *Wagner* matter, the trustee was appointed on February 28, 1972 by the U.S. District Court for the District of Massachusetts. Annexed hereto as Exhibit H is a copy of Touche Ross' letter to SIPC's General Counsel dated March 16, 1972 concerning the trustee's engagement of Touche Ross in that proceeding.

13. In addition to the foregoing, Touche Ross has served as the accounting firm engaged by trustees in the following cases:

(a) The liquidation under SIPA of Comstock Securities Limited in which the trustee was appointed on November 20, 1972 by the U.S. District Court.

(b) The liquidation under SIPA of First Midwest Investment Corporation in which the trustee was appointed on November 28, 1972 by the U.S. District Court for the Eastern District of Wisconsin.

(c) The liquidation under SIPA of Christian-Paine & Co., Inc. in which the trustee was appointed on April 18, 1974 by the U.S. District Court for the District of New Jersey.

14. Deponent has not ascertained the extent to which Touche Ross personnel who were engaged in the Weis Audit were also engaged in the foregoing six proceedings under SIPA.

WHEREFORE, deponent respectfully prays that the motion of the defendant under Rule 12(b)(1) and (6) of the Federal Rules of Civil Procedure be in all respects denied.

/s/ WILFRED R. CARON
Wilfred R. Caron

[Jurat and Exhibits
omitted in printing]

**Affidavit of Clarence Fried
in Opposition to Motion to Dismiss**

Filed January 10, 1977

UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

[Caption omitted in printing]

STATE OF NEW YORK }
COUNTY OF NEW YORK } ss.:

CLARENCE FRIED, being duly sworn, deposes and says:

1. I am a member of the firm of Hawkins, Delafield & Wood, attorneys for Securities Investor Protection Corporation ("SIPC"), one of the two plaintiffs in this action, and am fully familiar with the proceedings herein. I submit this Affidavit, together with the accompanying Affidavit of Wilfred R. Caron, in opposition to the present motion by defendant Touche Ross & Co. ("Touche Ross") for an order (i) dismissing the complaint herein, each of the causes of action therein alleged, and this action, on the grounds of lack of subject matter jurisdiction and failure to state a claim upon which relief can be granted, and (ii) to the extent that the foregoing relief is not granted, staying this action pending determination of a parallel action between the same parties as herein in the Supreme Court of the State of New York, New York County (the "State Court Action").

2. The plaintiffs in this action seek to recover the damages they suffered as a direct result of Touche Ross' failure to properly perform certain accounting services for Weis Securities, Inc. ("Weis"), a brokerage firm being liquidated under the Securities Investor Protection Act of 1970 ("SIPA"). Because of the liquidation of Weis and

pursuant to the obligation created by SIPA, plaintiff SIPC has paid over $14,000,000 to satisfy the claims of approximately 34,000 customers of Weis and may incur further expenses. Had Touche Ross performed its accounting services properly the Weis liquidation might have been avoided and certainly the cost to SIPC would have been substantially less.

THIS ACTION AND THE STATE COURT ACTION

3. In this action, SIPC seeks to recoup from Touche Ross, a firm of certified public accountants, the monies paid to the customers of Weis. SIPC's four initial counts (*i.e.*, the first through the fourth, Comp. ¶¶50-69) are predicated on Touche Ross' violation of the Securities Exchange Act of 1934 (the "1934 Act"). In addition, SIPC asserts four claims (i.e., the fifth through the eighth, Comp. ¶¶70-85) based on common law principles. The federal court's jurisdiction with respect to SIPC's counts arising under the 1934 Act is exclusive because of Section 27 of that Act. Thus, the federal court is the only court which can completely dispose of all the possible issues here involved, state as well as federal.

4. While the factual allegations in the State Court Action are similar to the allegations herein, the counts asserted by SIPC in the State Court Action are necessarily more limited than those contained in the complaint which Touche Ross would have this court dismiss. Obviously, the state court lacks jurisdiction to entertain SIPC's counts arising under the 1934 Act.

5. The State Court Action was instituted by the service of a summons without a complaint in July of 1975 as a precautionary measure to preserve the plaintiffs' state claims from the bar of the statute of limitations. By a series of letter agreements (dated July 2, 1975; December 19, 1975; and March 25, 1976) the parties to the State

Court Action agreed that all applicable statutes of limitations and time limits which had not run by July 2, 1976 were tolled and extended. The last in this series of letter agreements, dated March 25, 1976, a copy of which is annexed hereto as Exhibit A, provided in pertinent part:

> "The undersigned [Touche Ross] hereby confirms and agrees that all statutes of limitations and time limits applicable to any and all claims, or possible claims, against the undersigned by the Trustee and by SIPC, or by either of them, arising out of auditing and accounting services rendered by the undersigned to Weis Securities, Inc., which had not run before July 2, 1975, are further tolled and extended to May 3, 1976. Further, the undersigned agrees not to assert, and hereby waives any defense based upon the omission by the Trustee and by SIPC, or by either of them, to take legal action against the undersigned on and after the date hereof, to and including May 3, 1976, without prejudice to any defense based on such omission to take legal action prior to July 2, 1975."

6. Pursuant to the letter agreement of March 25, 1976, this action was commenced, by the filing of the complaint herein, on April 30, 1976. The complaint in the State Court Action was served several days later on May 3, 1976. Prior to the filing of the complaint herein, Touche Ross was obviously aware of the possibility that a federal court action would be commenced against it by SIPC and the Trustee in addition to the already-instituted State Court Action, because the letter agreements tolling and extending the running of the applicable statutes of limitations were entered into subsequent to the commencement of the State Court Action but prior to the commencement of this action.

7. Since its inception, the State Court Action—unlike this action—has been practically dormant. Touche Ross has neither answered nor moved with respect to the state

court complaint. Its time to do so has been extended by the most recent in a series of stipulations, dated October 28, 1976, a copy of which is annexed hereto as Exhibit B, to the forty-fifth day after the final determination by this court of the instant motion. That stipulation also provides that all proceedings in the State Court Action shall be stayed until a final determination by this court of the instant motion. Moreover, no disclosure has been obtained from any party in the State Court Action. In that action, defendant had propounded a set of interrogatories on each of the plaintiffs and had served notices to take the depositions of each of the plaintiffs. However, these interrogatories and notices of depositions were withdrawn pursuant to the aforementioned stipulation in the State Court Action. In sum, therefore, plaintiffs have not done anything in the State Court Action, except serve a summons and complaint on defendant.

8. In this action, on the other hand, Touche Ross has already partially answered a set of interrogatories propounded by the plaintiffs herein. In addition, to the extent that Touche Ross objected to those interrogatories, the plaintiffs herein moved to compel further answers and a hearing before Magistrate Schreiber was scheduled. By a stipulation in this action,* that motion was withdrawn without prejudice and the need for the hearing was obviated.

9. Thus, the facts indicate that, as between this action and the State Court Action, this action is the more comprehensive and farther advanced. In addition, I respectfully remind this court that, unlike the New York State court, it has special expertise and familiarity with SIPA liquidations, and particularly with the proceedings which have resulted from the liquidation of Weis.

* For the convenience of the court, a copy of the stipulation, "so ordered" by Judge Wyatt on November 12, 1976, is annexed hereto as Exhibit C.

The Absence of a Touche Ross Partner Resident in Washington, D.C.

10. Touche Ross challenges the jurisdiction of this court over SIPC's claims in this action on the ground, *inter alia,* that the citizenship of SIPC and Touche Ross is not diverse for the purposes of 28 U.S.C. §1332. Touche Ross contends that SIPC's failure to allege that no Touche Ross partner resides in Washington, D.C., of which SIPC is a citizen, renders the invocation of that Section as a basis for this court's jurisdiction defective. Significantly, however, Touche Ross has failed to submit any evidence indicating that one of its partners does reside in the District of Columbia. Touche Ross' failure to submit such evidence is understandable in view of the apparent facts. On information and belief, no Touche Ross partner resides in Washington, D.C. The information upon which this belief is based is contained in the Directory for 1976-77 of Touche Ross partners and managers. The partners listed therein under the heading "Washington, D.C." do not include a single individual who resides in the District of Columbia. Rather, all of Touche Ross' Washington, D.C. partners appear to reside in either Maryland or Virginia. The relevant portion of the Touche Ross Directory for 1976-77 is annexed hereto as Exhibit D.

11. In light of the facts contained in this Affidavit and in the accompanying Affidavit of Wilfred R. Caron, and for the reasons set forth in SIPC's accompanying memorandum of law, it is respectfully submitted that the instant motion of defendant Touche Ross be in all respects denied.

/s/ Clarence Fried
Clarence Fried

[Jurat and Exhibits omitted in printing]

Affidavit of Bruce E. Baker in Opposition to Motion to Dismiss

Filed January 10, 1977
UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

[Caption omitted in printing]

STATE OF NEW YORK }
COUNTY OF NEW YORK } ss.:

BRUCE E. BAKER, being duly sworn, deposes and says:

1. I reside at 47 Orange Drive, Jericho, New York. I am the head of the administrative staff maintained for Weis Securities matters by Edward S. Redington, Esq., Trustee for the liquidation of the business of Weis Securities, Inc. pursuant to the Securities Investor Protection Act of 1970. I make this affidavit in opposition to a motion by defendant Touche Ross & Co. to dismiss this action on jurisdictional and other grounds.

2. Pursuant to court order dated June 1, 1973, all proofs of claim and customer claims asserted in the Weis liquidation have been filed with the Trustee as directed by the court order. Upon receipt, proofs of claim were time- and date-stamped and then placed in appropriate files by the Trustee's administrative staff. The files containing the proofs of claim and any related correspondence or documentation are maintained by the Trustee's administrative staff under my supervision and control.

3. Annexed hereto as Exhibit A is a true copy from the Trustee's files of one of the two proofs of claim filed in the Weis liquidation by defendant Touche Ross & Co. The stamp on the face of the proof of claim indicates that it was received by the Trustee's administrative staff at 11:31 A.M. on July 13, 1973. The notations "'A'" and

"total $87,107.00" on the face of the proof of claim were added by a member of the Trustee's administrative staff for processing purposes.

4. Annexed hereto as Exhibit B is a true copy from the Trustee's files of a second proof of claim filed in the Weis liquidation by defendant Touche Ross & Co. for "services rendered for benefit of estate." Again, a stamp on the face of the proof of claim indicates that it was received by the Trustee's administrative staff at 11:31 A.M. on July 13, 1973. The notation "'B'" and the accompanying scribble on the upper righthand corner of the face of the proof of claim were added by a member of the Trustee's administrative staff for processing purposes.

WHEREFORE, deponent respectfully requests that since defendant Touche Ross & Co. has consented to the jurisdiction of this Court by filing the claims identified in paragraphs 3 and 4, its motion to dismiss the Trustee's claims for relief on jurisdictional grounds be denied.

/s/ BRUCE E. BAKER
Bruce E. Baker

[Jurat omitted in printing]

Exhibit A to Affidavit
of Bruce E. Baker

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION, *Plaintiff,*	
SECURITIES INVESTOR PROTECTION CORPORATION, *Applicant,*	73 Civ. 2332
v.	
WEIS SECURITIES, INC., *Defendant.*	

PROOF OF CLAIM BY INDIVIDUAL

STATE OF
COUNTY OF } ss.:

Touche Ross & Co. of No. 1633 Broadway Street, in New York, County of New York, State of New York, says:

1. That Weis Securities, Inc., the above-named defendant, was at and before May 24, 1973 and still is, justly and truly indebted [*or* liable] to the undersigned in the sum of $75,443 dollars.

2. That the consideration of this debt [*or* liability] is as follows: see attached

3. That no part of the debt [*or* liability] has been paid except none

4. That there are no set-offs or counterclaims to the debt [*or* liability] except none

5. That this creditor does not hold, and has not, nor has any person by his order, or to his knowledge or belief, for his use, had or received, any security or securities for the debt [*or* liability] except none

6. [*If the debt or liability is founded upon an instrument of writings*] That the instrument upon which the debt [*or* liability] is founded is attached hereto [*or* is lost or destroyed, as set forth in the affidavit attached hereto].

7. [*If the debt is founded upon an open account*] that the debt was [*or* will become] due on
[*or* that the average due date thereof is],
that no note or other negotiable instrument has been received for such account or any part thereof [*or* that the debt is evidenced by a note [*or* other negotiable instrument], which is attached hereto]; and that no judgment has been rendered thereon, except

Dated at New York, this 11th day of July, 1973.

/s/ TOUCHE ROSS & CO.
Creditor

/s/ LOUIS J. HAAG,
Partner

There are penalties for presenting fraudulent claims.

TOUCHE ROSS & CO.

1633 BROADWAY
NEW YORK, NEW YORK 10019

July 10, 1973

Mr. Edward S. Redington
Trustee in Liquidation of
Weis Securities Inc.
Hughes, Hubbard & Reed
One Wall Street
New York, N.Y. 10005

FOR SERVICES RENDERED to Weis Securities Inc.

For services rendered covering the regular New York Stock Exchange, Inc. audit as of April 27, 1973 for the purpose of examining the Answers to Financial Questionnaire and Statement of Financial Condition as of that date. (Examination was not completed nor were reports submitted)	$67,972
Services rendered by our London office covering the examination of the accounts and records, systems review and accounting systems of Weis, Voisin & Co., Inc.—London Branch and Weis, Voisin & Co. International Limited, as of November 24, 1972— £2,077.64	5,313
Services rendered by our Paris Office covering the examination of financial statements of Weis, Voisin S.A.R.L.—Paris as of November 24, 1972, value added tax problem and meeting to discuss present and future operations, F.7,350	1,900
Services rendered by our Paris Office covering the preparation of the French corporate income tax return for Weis, Voisin S.A.R.L.—Paris for the year ended December 31, 1972 filed April 30, 1973— F.1,000	258
Total	$75,443

Exhibit B to Affidavit
of Bruce E. Baker

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,
Plaintiff,

SECURITIES INVESTOR PROTECTION CORPORATION,
Applicant,

v.

WEIS SECURITIES, INC.,
Defendant.

73 Civ. 2332

PROOF OF CLAIM BY INDIVIDUAL

STATE OF
COUNTY OF } ss.:

Touche Ross & Co., of No. 1633 Broadway Street, in New York, County of New York, State of New York, says:

1. That Weis Securities, Inc., the above-named defendant, was at and before May 24, 1973 and still is, justly and truly indebted [*or* liable] to the undersigned in the sum of $11,664 dollars.

2. That the consideration of this debt [*or* liability] is as follows: see attached

3. That no part of the debt [*or* liability] has been paid except none

4. That there are no set-offs or counterclaims to the debt [*or* liability] except none

5. That this creditor does not hold, and has not, nor has any person by his order, or to his knowledge or belief, for his use, had or received, any security or securities for the debt [*or* liability] except none

6. [*If the debt or liability is founded upon an instrument of writings*] That the instrument upon which the debt [*or* liability] is founded is attached hereto [*or* is lost or destroyed, as set forth in the affidavit attached hereto].

7. [*If the debt is founded upon an open account*] That the debt was [*or* will become] due on
[*or* that the average due date thereof is
], that no note or other negotiable instrument has been received for such account or any part thereof [*or* that the debt is evidenced by a note [*or* other negotiable instrument], which is attached hereto]; and that no judgment has been rendered thereon, except

Dated at New York, this 11th day of July, 1973.

/s/ TOUCHE ROSS & CO.
Creditor

/s/ LOUIS J. HAAG,
Partner

There are penalties for presenting fraudulent claims.

TOUCHE ROSS & CO.

1633 BROADWAY
NEW YORK, NEW YORK 10019

July 10, 1973

Mr. Edward S. Redington
Trustee in Liquidation of
Weis Securities Inc.
Hughes, Hubbard & Reed
One Wall Street
New York, N.Y. 10005

FOR SERVICES RENDERED to Weis Securities Inc.

For services rendered for benefit of estate:

Meetings and conferences with personnel of the New York Stock Exchange, Inc. and the Securities and Exchange Commission;	$ 4,537
Substantiation and documentation of alleged fraudulent bookkeeping practices and entries;	2,975
Confirmation of bank loans and related collateral as of April 13, 1973 applicable to the alleged fraudulent bookkeeping entries	4,152
Total	$11,664

Reply Affidavit of Arnold I. Roth in Support of Motion to Dismiss

Filed February 7, 1977

UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

[Caption omitted in printing]

STATE OF NEW YORK }
COUNTY OF NEW YORK } ss.:

ARNOLD I. ROTH, being duly sworn, deposes and says:

1. On January 20, 1977, after plaintiffs had served their opposing papers herein, the Second Circuit decided *Lank* v. *New York Stock Exchange* (Docket No. 76-7243). For the convenience of the Court, and because *Lank* is controlling here (a controlling effect which is conceded by plaintiffs, who rely heavily upon the reversed District Court decision) and requires dismissal of plaintiffs' "causes of action" under Section 17 of the 1934 Act, a copy of the Second Circuit's slip opinion is annexed hereto as Exhibit 1.

2. Among the pertinent materials for replying to plaintiffs' opposing papers are the annual reports of plaintiff SIPC. Consequently, pertinent portions of plaintiff SIPC's First Annual Report (1971), Second Annual Report (1972), Third Annual Report (1973) and Fifth Annual Report (1975) are annexed hereto as, respectively, Exhibits 2, 3, 4 and 5.

3. Arguing against the alternative relief sought by defendant Touche Ross—*viz.*, a stay of all proceedings in this action, to the extent that it is not dismissed, pending determination of plaintiffs' earlier commenced and almost identical State Court Action—plaintiffs seek (by means of the moving affidavit of Clarence Fried) to create the

misleading impression that the State Court Action had to be commenced for protection against the statute of limitations, that the State Court Action has been dormant since its inception, and that this action is substantially more advanced than the State Court Action. Brief recitation of the facts demonstrates the misleading nature of plaintiffs' contentions.

(a) Mr. Fried asserts that the State Court Action was instituted "as a precautionary measure to preserve the plaintiffs' state claims from the bar of the statute of limitations" (Fried Aff. ¶5). However, by the time the State Court Action was commenced on July 3, 1975, plaintiffs and defendant Touche Ross had already entered into the first of the series of letter agreements by which even Mr. Fried concedes "all applicable statutes of limitations and time limits . . . were tolled and extended". That first letter agreement was dated July 2, 1975, and was supplemented by further letter agreements dated December 19, 1975 and March 25, 1975. Since Mr. Fried attaches to his affidavit only the last of those letter agreements, the first two are annexed hereto as, respectively, Exhibits 6 and 7. In this connection, I call the Court's attention to the fact that Mr. Fried misstates the operative language (which is the same in all three letters) when he quotes it as saying "all applicable statutes of limitations and time limits which had not run by *July 2, 1976* were tolled and extended". The misstatement by Mr. Fried is with respect to the underlined date, for in each of the letter agreements the actual date is not July 2, 1976, but instead, *July 2, 1975,* the day before the commencement of the State Court Action. Thus, the parties had agreed prior to the commencement of the State Court Action to toll and extend all applicable statutes of limitations, and *the commencement of the State Court Action for that purpose was (and was known to plaintiffs to be) unnecessary.*

(b) In asserting that the State Court Action "has been practically dormant", Mr. Fried erroneously asserts that defendant Touche Ross "has neither answered nor moved" therein and, while conceding that defendant Touche Ross "propounded a set of interrogatories on . . . and . . . served notices to take the depositions of each of the plaintiffs", misleadingly suggests that defendant Touche Ross withdrew those interrogatories and notices without more (Fried Aff. ¶7). In fact, defendant Touche Ross not only served its extensive interrogatories and its notices to take depositions (referred to in my moving affidavit), but also moved to dismiss portions of the complaint in the State Court Action. A copy of the defendant Touche Ross' notice of motion to dismiss is annexed hereto as Exhibit 8.

(c) To support the suggestion that this action is more advanced than the State Court Action, Mr. Fried misleadingly asserts that defendant Touche Ross "has already partially answered a set of interrogatories propounded by the plaintiffs herein" (Fried Aff. ¶8). However, defendant Touche Ross' answers do not represent the advancement of this action which plaintiffs would suggest. After the complaint in this action was served, defendant Touche Ross sought an extension of its time to move or answer in order to be able adequately to deal with the numerous and complex issues which, as it informed plaintiffs, it intended to raise on a motion to dismiss. Plaintiffs' attorneys were unwilling to grant the necessary and concededly reasonable extensions without demanding as a *quid pro quo* a concession from defendant Touche Ross that they could, *inter alia,* serve certain interrogatories. Although defendant Touche Ross expressly objected to any discovery taking place prior to determination of the motion to dismiss and to the exaction of the *quid pro quo,* it was forced to agree (in order to obtain plaintiffs' agreement to the necessary extension) that plaintiffs could, *inter alia,*

serve interrogatories which "shall be of a preliminary or structural nature, and shall not seek information on the substance of the causes of action alleged in the complaint". Contrary to the express requirements of the stipulation embodying that agreement, a copy of which is annexed hereto as Exhibit 9, and as defendant Touche Ross had feared, the interrogatories actually served by plaintiffs sought extensive information which was non-preliminary and was of a substantive nature. Despite the improprieties of the interrogatories, defendant Touche Ross responded to them by answering them to the extent that they were within the scope of the stipulation and otherwise proper, and by objecting to them to the extent that they were beyond the scope of the stipulation or otherwise improper. The answers, which primarily identify certain personnel of and documents issued by defendant Touche Ross, are of the most "preliminary" nature, and do not go to the substance of the issues in this action. The answers to the interrogatories do not constitute any substantial start on discovery, and no other discovery has occurred in this action.

(d) By October 1976, the parties hereto were involved in a number of procedural and substantive motions in this action and the State Court Action. Defendant Touche Ross had made the present motion to dismiss this action. Defendant Touche Ross had made its motion to dismiss portions of the State Court Action. Plaintiffs, seeking to whipsaw defendant Touche Ross on discovery, had moved in this action to compel defendant Touche Ross to further answer their improper interrogatories, while at the same time moving in the State Court Action to block defendant Touche Ross from obtaining the discovery sought by its interrogatories and notices of depositions therein. In late October 1976, the parties agreed that all proceedings in this action and the State Court Action should be held in abeyance pending

the resolution of the present motion to dismiss this action, and effectuated that agreement by entering into the two stipulations dated October 28, 1976 and annexed to Mr. Fried's affidavit as Exhibit B.

4. The point of the foregoing is that this action is no further advanced than the State Court Action, and plaintiffs mislead in suggesting to the contrary. Consequently, the relative procedural postures do not militate against the stay and, in light of the fact that the State Court Action was commenced long before this action, actually weigh in favor of the stay. Other pertinent factors which also dictate that the stay be granted are discussed in detail in defendant Touche Ross' moving papers and include such overriding considerations as the fact that plaintiffs' claims involve basically questions of common law negligence and malpractice, and the fact that such questions are more appropriately to be resolved by the State courts.

5. A decision pertaining to the question of a stay is *Finkelstein* v. *Wolf,* a summary of which is reported at C.C.H. Fed. Sec. L. Rep. ¶94,885 (1974). A full copy of that decision is annexed hereto as Exhibit 10.

/s/ ARNOLD I. ROTH
Arnold I. Roth

[Jurat and Exhibits omitted in printing]

[428 F. Supp. 483]

Opinion of the District Court

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

[March 1, 1977]

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,
Plaintiffs,

—against—

TOUCHE ROSS & Co.,
Defendant.

76 Civ. 1981

APPEARANCES:

HUGHES HUBBARD & REED, ESQS.
Attorneys for Plaintiff Edward S. Redington, as Trustee for the liquidation of the business of Weis Securities, Inc.
One Wall Street
New York, New York 10005

JOHN S. ALLEE, ESQ.
JAMES B. KOBAK, JR., ESQ.
WILLIAM S. BARRETT, ESQ.
of Counsel

HAWKINS, DELAFIELD & WOOD, ESQS.
Attorneys for Plaintiff
Securities Investor Protection Corporation
67 Wall Street
New York, New York 10005

CLARENCE FRIED, ESQ.
WILFRED R. CARON, ESQ.
MICHAEL S. DOW, ESQ.
RAFAEL PASTOR, ESQ.
of Counsel

ROSENMAN COLIN FREUND LEWIS & COHEN, ESQS.
Attorneys for Defendant Touche Ross & Co.
575 Madison Avenue
New York, New York 10022

ARNOLD I. ROTH, ESQ.
JAMES K. NEVLING, JR., ESQ.
ARTHUR LINKER, ESQ.
MARC S. DREIER, ESQ.
STEVEN A. ASHER, ESQ.
of Counsel

[428 F. Supp. 485]

WYATT, District Judge.

This is a motion by defendant Touche Ross & Co. (Touche) to dismiss the complaint pursuant to Rule 12(b) of the Federal Rules of Civil Procedure, on two grounds: that the Court lacks subject matter jurisdiction, and that the complaint fails to state a claim upon which relief can be granted; in the alternative, it is sought to stay this

[428 F. Supp. 486]

action pending determination of an action between the same parties in the New York Supreme Court, New York County.

1.

Weis Securities, Inc. (Weis), was a large stock brokerage house. Weis was a broker-dealer registered with the Securities and Exchange Commission (SEC) and was a member of the New York Stock Exchange and of other stock exchanges. Weis is said to be a corporation, although where incorporated does not appear; its principal place of business is said to have been in the City of New York.

Touche is a firm of certified public accountants and acted as such for Weis.

In May 1973, Securities Investor Protection Corporation (SIPC) applied to this Court for a decree adjudicating, under the Securities Investor Protection Act of 1970 (15 U.S.C. §§ 78aaa and following; "SIPA"), that customers of Weis were in need of protection under SIPA, appointing a trustee for the liquidation of Weis, and affording other relief. This Court granted the application and appointed Edward S. Redington as Trustee (referred to usually as the "Trustee"). The proceedings in which the Trustee was appointed are described in *Exchange National Bank v. Wyatt,* 517 F.2d 453 (2d Cir. 1975). The Trustee was appointed on May 30, 1973; the "filing date" (15 U.S.C. § 78eee(b)(4)(B)) was May 24, 1973. Weis has since been in liquidation under SIPA.

2.

On July 3, 1975, the Trustee and SIPC commenced an action against Touche in New York Supreme Court, New York County (Index No. 13996/76; the action has a 1976 number because the first paper filed in the action was in 1976). The causes of action of each plaintiff were separately stated but there were in the complaint 21 paragraphs of "common allegations" which were then incorporated by reference in each claim of the Trustee and in each claim of SIPC. There were five causes of action by the Trustee and four causes of action by SIPC.

3.

The case at bar was commenced in this Court on April 30, 1976. The parties are the same as those in the State action. The Trustee and SIPC are again suing Touche.

The complaint in the case at bar asserts exactly the same claims as in the State action and adds claims by the Trustee and SIPC based on alleged violations by Touche

of the Securities Exchange Act of 1934 (15 U.S.C. §§ 78a and following; "the 1934 Act"), specifically of Section 17 of the 1934 Act (15 U.S.C. § 78q).

The "common allegations" are the same in both actions except that three paragraphs have been added here to shore up the added Section 17 claims of the Trustee and SIPC.

In this action, there are 6 claims by the Trustee and 8 claims by SIPC. (The claims are mistakenly called causes of action in the complaint, ignoring Fed.R.Civ.P. 8 and following the nomenclature in the State courts.)

The two plaintiffs have joined as such (presumably under Fed.R.Civ.P. 20(a) and properly) but their claims are several, not joint, and are stated in separate counts.

Counts two through six of the complaint in the case at bar are exactly the same as the five causes of action of the Trustee in the State action. Count one in the case at bar is the added claim under Section 17 of the 1934 Act.

The first four claims of SIPC in the case at bar are not in the State Action and are apparently intended to be based on Section 17 of the 1934 Act although in the first four counts there is no express reference to Section 17 (except as paragraphs 1, 16, 17, 21, and 22 of the complaint are incorporated by reference in these counts). The other four SIPC claims in the case at bar are exactly the same as the four SIPC causes of action in the State action.

[428 F. Supp. 487]

4.

The claims in the case at bar are alleged to arise under the 1934 Act and particularly under Section 17 thereof (15 U.S.C. § 78q), under Section 6 of SIPA (15 U.S.C. § 78fff), and under the common law (complaint, para 1).

The complaint avers that the Court has jurisdiction over the claims of the Trustee under Section 27 of the 1934 Act and under 28 U.S.C. § 1331. It further avers (in effect) that the Court has jurisdiction in bankruptcy by virtue of Section 6 of SIPA (15 U.S.C. § 78fff), under Sections 2a(7), 102 and 115 of the Bankruptcy Act (11 U.S.C. §§ 11a(7), 502 and 515), and under 28 U.S.C. § 1334. The complaint also avers jurisdiction over the common law claims of the Trustee under principles of pendent jurisdiction (complaint, para 2).

Jurisdiction over SIPC's claims is alleged to exist under Section 27 of the 1934 Act and 28 U.S.C. § 1331, under the diversity of citizenship statute (28 U.S.C. § 1332) and under principles of pendent jurisdiction (complaint, para 3).

There then follows a series of "Common Allegations" comprising 24 paragraphs of the complaint which are incorporated by reference in both the six counts pleaded by the Trustee and the eight counts pleaded by SIPC.

The complaint avers that five of Weis' officers misstated the financial condition and results of operation of Weis in financial reports prepared at the end of fiscal year 1972, and that such reports were required to be filed with regulatory authorities pursuant to Section 17 of the 1934 Act. It alleges that these reports were directly or indirectly submitted to Weis, its Board of Directors, the SEC, SIPC, the Exchange, and Weis' customers, creditors, lenders and shareholders.

Plaintiffs aver that Touche breached duties it assumed toward them under Section 17 of the 1934 Act and under the common law when it became Weis' auditor and undertook to perform all necessary auditing and accounting services needed to audit the reports of financial condition that Weis was required to submit to the SEC. Essentially, these "common allegations" charge Touche with negligence and recklessness in the performance of its services (para 28); SIPC argues that they also

charge wilful misconduct (Memorandum of Plaintiff SIPC in Opposition to Defendant's Motion to Dismiss, p. 5). The complaint also alleges that Touche falsely certified that it had performed the necessary services and made false representations with respect to the Answers to Financial Questionnaire and other documents dated May 26, 1972. The "common allegations" then state that because of these failures and misrepresentations of Touche, the Exchange, the SEC and SIPC were prevented from knowing the true condition of Weis, and were prevented from acting to safeguard the assets of Weis and the property held by Weis for its customers; and that Weis continued to undertake financial obligations which it could not satisfy. As a result of the failure to act of the regulatory authorities, the liquidation of Weis became necessary when the facts were discovered. This was after the Weis assets and the property held by it for customers had been further depleted, and when it was too late to take remedial action. Upon liquidation, SIPC was required under SIPA to provide the Trustee with funds for the payment of claims submitted by customers and "certain other creditors" of Weis.

Paragraphs 32-49 of the complaint state six claims by the Trustee against Touche. The first claim charges that Touche violated, and aided and abetted the Weis officers in violating, Section 17 of the 1934 Act and the rules and regulations promulgated thereunder, which require broker-dealers (such as Weis) to file accurate reports of their financial condition, including reports such as those certified by Touche. It further states (para 34) that "Weis, its Board of Directors, its creditors, customers, lenders and shareholders were among the class of persons which Section 17 of the 1934 Act was designed to protect and were among the beneficiaries of duties imposed on Touche Ross by Section 17 of the 1934

Act",

[428 F. Supp. 488]

and that the injuries which occurred as a result of the liquidation of Weis were of the type that Section 17 was intended to prevent.

The Trustee's other five claims state that Touche breached duties to Weis under the common law of New York. The second claim charges Touche with negligence per se in violating Section 17 of the 1934 Act. The third charges Touche with negligence and malpractice. The fourth charges Touche with recklessness and gross negligence. The Trustee's fifth claim charges breach of contract. The sixth claim charges breach of express and implied warranties that Touche would comply with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and the SEC.

In paragraphs 52-85 of the complaint, SIPC alleges eight claims against Touche, four on its own behalf and four on behalf of Weis' customers and certain other creditors. The first four claims allege violations of Section 17 of the 1934 Act and the others allege violations of the common law.

SIPC's first claim is under Section 17 of the 1934 Act and charges that Touche failed to comply with the auditing standards and regulations prescribed by the 1934 Act and the rules promulgated thereunder in that opinion letters, answers to the financial questionnaire and financial statements prepared by Touche were false, inaccurate and incomplete, and that as a consequence the SIPC fund has been depleted in order to satisfy the claims of 34,000 customers and other creditors. Its third claim (also under Section 17) charges that Touche had knowledge, or, but for its errors and omissions, would have had knowledge, of the deceptions caused by the Weis officers in violation of the 1934 Act and that Touche aided and abetted the Weis officers in this

deception. The fifth claim (under common law) charges Touche with negligence and malpractice. The seventh claim (under common law) charges Touche with recklessness and gross negligence. SIPC's second, fourth, sixth and eighth claims are the same respectively as the first, third, fifth and seventh claims above described except that the second, fourth, sixth and eighth claims aver that Touche violated duties to the customers and certain other creditors of Weis and that SIPC is subrogated to the claims which such customers and other creditors could have asserted, this because SIPC has compensated them out of the SIPC fund.

5.

As seen above, the Trustee's first claim and the first, second, third, and fourth claims of SIPC are asserted under Section 17 of the 1934 Act (15 U.S.C. § 78q).

The argument for Touche is that there is no provision in Section 17 for a private right of action (as, for example, there is in Section 16) and that no private right of action is maintainable under Section 17.

The argument for plaintiffs is that, while no private right of action is expressly provided for in Section 17, a right of action should be implied for parties such as SIPC, the Trustee and customers and creditors of Weis who are said to fall within the "class for whose *especial* benefit the statute was enacted", citing *Cort* v. *Ash*, 422 U.S. 66, 78, 95 S.Ct. 2080, 45 L.Ed.2d 26 (1975; emphasis in original), which quoted from *Texas & P.R. Co.* v. *Rigsby*, 241 U.S. 33, 39, 36 S.Ct. 482, 60 L.Ed. 874 (1916).

6.

If there were any violations by Touche of Section 17, they occurred in 1972. Since then, there have been extensive amendments (in 1975) to Section 17 but in 1972 the relevant part of Section 17 read as follows:

> "Every national securities exchange, every member thereof, every broker or dealer who transacts a business in securities through the medium of any such member, every registered securities association, and every broker or dealer registered pursuant to section 78o of this title, shall make, keep, and preserve for such periods, such accounts, correspondence, memoranda, papers, books, and other

[428 F. Supp. 489]

> records, and make such reports, as the Commission by its rules and regulations may prescribe as necessary or appropriate in the public interest or for the protection of investors. Such accounts, correspondence, memoranda, papers, books, and other records shall be subject at any time or from time to time to such reasonable periodic, special, or other examinations by examiners or other representatives of the Commission as the Commission may deem necessary or appropriate in the public interest or for the protection of investors."

From the wording of this provision and in the context of the other provisions of the 1934 Act, it would appear that Section 17 was designed to supply administrative guidance in the bookkeeping area and not to create any rights in anybody. Section 17 has also been used as authority for the inspection program of the SEC, which is somewhat like the inspection work of the bank examiners.

In the 43 years during which the statute has been on the books, there has been no decision whether a private right of action can be asserted for a violation of Section 17. The Supreme Court, about a year ago, refused to consider whether there was such a private cause of action. *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 194 fn. 13, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976).

There is nothing explicit to show any legislative intent respecting a private claim under Section 17.

The section, however, is entitled "Accounts and records, reports . . . ." and the very next section is entitled "Liability for misleading statements". This next section, Section 18 (15 U.S.C. § 78r), creates a private cause of action for "misleading statements" in "any application, report, or document filed pursuant to this chapter . . . " in favor of any person who purchased or sold a security at a price affected by the misleading statements. The subject matter of the two sections, their titles, and their juxtaposition would strongly suggest a legislative intent that the *only* private claim for a violation of Section 17 was the claim created in Section 18. Plaintiffs here are obliged to argue that there is an implied private claim under Section 17 *broader* than the claim *expressly* created by Section 18. This is because they did not purchase nor sell any security "at a price affected . . . " etc., and thus cannot state a claim under Section 18. In this connection, it may be well to recall the words of the Supreme Court in *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 736, 95 S.Ct. 1917, 1925, 44 L.Ed.2d 539 (1975):

> "Section 18 of the 1934 Act, prohibiting false or misleading statements in reports or other documents required to be filed by the 1934 Act, limits the express remedy provided for its violation to 'any person . . . who . . . shall have purchased or sold a security at a price which was affected by such statement . . . '. It would indeed be anomalous to impute to Congress an intention to expand the plaintiff class for a judicially implied cause of action beyond the bounds it delineated for comparable express causes of action."

Sections 13(a) and 13(d) of the 1934 Act (15 U.S.C. § 78m(a) and (d)) require the filing of specified reports by issuers and the filing of reports by those who acquire more than 5% of a registered equity security. Claims have been asserted under this Section by those who were not purchasers or sellers of any security and who thus could not state a claim under Section 18. They asked the Courts, as the plaintiffs do here, to imply a private right of action from the section alleged to have been violated. The Courts have declined to do so, holding that Section 18 is the only civil liability provision for a violation of the "reporting provisions" of the 1934 Act. *Meer* v. *United Brands Co.,* CCH Fed.Sec.L.Rep. ¶ 95,648 (S.D.N.Y. July 6, 1976; Carter, J.); *Myers* v. *American Leisure Time Enterprises,* 402 F.Supp. 213 (S.D.N.Y. 1975; Weinfeld, J.), affirmed without opinion 538 F.2d 312 (2d Cir. 1976); *In re Penn Central Securities Litigation,* 347 F.Supp. 1327, 1340 (E.D.Pa. 1972), affirmed 494 F.2d 528 (3d Cir. 1974).

[428 F. Supp. 490]

In *In re Penn Central Securities Litigation,* cited above, the District Court stated (347 F.Supp. at 1340):

> "Section 13 is one of a number of provisions that require the filing of applications, documents and reports. See §§ 12(b), 12(g), 15(b)(1), 15A(a), 16(a) and 17(a). Section 18(a) is the 'catch-all' civil liability provision for all of the reporting requirements of the Exchange Act, and we conclude that it is the exclusive remedy for violation of § 13(a)."

Opposed to the suggestion that the only protection intended for a violation of Section 17 was the liability created in Section 18, is the argument that customers of brokers and dealers in their dealings with such brokers

and dealers can never rely on the relief provided by Section 18 because in such dealings they can never meet the purchaser-seller requirement of that section. Section 17, runs the argument, was intended to protect those who choose to leave securities they have purchased, or cash resulting from securities they have sold, with their broker. Section 17's purpose is to protect these people by requiring their brokers to file reports with the SEC so that the SEC (and now SIPC as well) might police their activities so as to ensure the solvency of brokers.

Although Section 18 might not, of itself, foreclose the implication of a private right of action under Section 17, this does not mean that Section 18 is irrelevant to the question here.

It should be noted that when Congress wanted to create private causes of action for violations of provisions of the 1934 Act, it knew how to do it and did do it. In addition to the "reporting" violations made the subject of private rights of action in Section 18, Congress specifically provided for civil liability in Section 9(e) (15 U.S.C. § 78i(e)) and Section 16(b) (15 U.S.C. § 78p(b)) of the 1934 Act. Congress also provided for "liabilities of controlling persons" in Section 20 of the 1934 Act (15 U.S.C. § 78t).

Nor is it necessary to imply a civil liability under Section 17 in order to enforce its provisions. There can be a criminal prosecution. *United States* v. *Sloan,* 389 F.Supp. 526 (S.D.N.Y. 1975). The SEC can secure an injunction where a violation is proved of Section 17, described by Judge Tenney as "the bookkeeping rule". *SEC* v. *Resch-Cassin & Co., Inc.,* 362 F.Supp. 964, 979 (S.D.N.Y. 1973).

It remains to consider *J. I. Case Company* v. *Borak,* 377 U.S. 428, 84 S.Ct. 1555, 12 L.Ed.2d 423 (1964) on which plaintiffs properly rely. In *Borak* a private right of action was implied for a violation of Section 14(a) of the

1934 Act (15 U.S.C. § 78n(a)) despite the lack of any provision therein for a private right of action and despite the existence of the civil liability provision in Section 18 (15 U.S.C. § 78r).

Borak was a suit by a stockholder of Case, the management of which solicited proxies for voting in favor of a merger of Case with another corporation. It was alleged that the proxy solicitation material was false and was in violation of Section 14(a) of the 1934 Act; that the merger would not have been approved by stockholders were it not for the false and misleading statements; and that the stockholders of Case had been damaged.

Section 14(a), together with an SEC Rule prescribed thereunder, makes it unlawful to solicit proxies by means of a proxy statement to stockholders containing false or misleading statements.

There is nothing in the statute which requires any filing with the SEC of proxy statements or other soliciting material. But the regulations of the SEC under Section 14(a) require that "preliminary copies" of the proxy statement or other soliciting material be filed with the SEC, as well as "definitive copies". 17 CFR § 240.14a-6

Soliciting material is plainly intended for the information of the stockholders, not of the SEC. The SEC has only an oversight or policing function.

In *Borak* a private right of action was implied because plaintiff, one of the stockholders solicited, was of the class intended to be protected by the statute; and because

[428 F. Supp. 491]

such private action was a "necessary supplement to Commission action" (377 U.S. at 432, 84 S.Ct. 1555) since the SEC had not the time for an "independent examination" of the soliciting material filed with it (377 U.S. at 432, 84 S.Ct. 1555).

But the case at bar is not like *Borak*. The reports required by Section 17 in 1972 were not for the information of any "investors" and were not sent to them but were for the SEC, primarily for monitoring the net capital requirements of the 1934 Act (Section 8(b); 15 U.S.C. § 78h(b)). Moreover, in examining the records and reports made under Section 17(a) the SEC does not have the time limitations applicable to the *Borak* proxy statements (ten days in some cases (17 CFR § 240.14a-6(a)) and two days in others (17 CFR § 240.14a-6(b)). The SEC has an inspection program, similar to that of bank examinations. It is not "necessary" to enforce Section 17 by private actions; criminal prosecutions and SEC injunctive actions seem abundantly sufficient. If, as is the case, the record keeping requirements of Section 17 are to give early warning to the SEC of financial difficulties of a broker and thus avoid liquidation, it cannot help to imply a private right of action *after* liquidation has become a fact.

The Supreme Court has refused to expand the *Borak* principle; indeed, the Court has restricted it.

In *Cort v. Ash*, 422 U.S. 66, 95 S.Ct. 2080, 45 L.Ed.2d 26 (1975), the Supreme Court refused to imply a private right of action for a violation of 18 U.S.C. § 610. The Court referred to *Borak* as an instance where there was "a pervasive legislative scheme governing the relationship between the plaintiff class and the defendant class in a particular regard" (422 U.S. at 82, 95 S.Ct. at 2090). There is no such "pervasive legislative scheme" in the case at bar.

And only last week, the Supreme Court, reversing our Court of Appeals, declined to imply a private right of action under Section 14(e) of the 1934 Act. *Piper* v. *Chris-Craft Industries, Inc.*, ____ U.S. ____, 97 S.Ct. 926, 51 L.Ed.2d 124 (1977).

The test was whether "the creation by judicial interpretation of the implied cause of action . . . is *necessary* to effectuate Congress' goals" (emphasis supplied). This test has already been applied here and no such implication found "necessary".

The Supreme Court determined that plaintiff in *Chris-Craft* was not an intended beneficiary of the legislation. Here, neither the Trustee nor SIPC could possibly have been meant to be protected by Section 17, if for no other reason because the SIPA legislation was not passed until more than thirty years after Section 17. Additionally, neither the Trustee nor SIPC is an investor.

The case of *Lank* v. *The New York Stock Exchange*, 548 F.2d 61 (2d Cir. 1977), is instructive in this respect. There our Court of Appeals refused to imply a private right of action in the receiver of a member of the Exchange under Section 6 of the 1934 Act. The Court emphasized that brokers were not investors to be protected by the 1934 Act and that Section 6 was not enacted "for the purpose of affording protection to the very members of the stock exchanges whose conduct was being regulated . . . ". This analysis seems applicable to the plaintiffs in the case at bar.

Finally, Section 17 does not impose any duty on accountants. It specifically mentions a "national securities exchange", the members thereof, a "registered securities association", brokers, and dealers; it does not mention accountants. While the regulations do contain provisions respecting an accountant's certificate (17 CFR § 240.17a-5(f)(g)(h)(i)), the oath is only by the broker or dealer (17 CFR § 240.17a-5(b)(2)). Judge Weinfeld discussed the problem in *Rothstein* v. *Seidman & Seidman*, 410 F.Supp. 244 (S.D.N.Y. 1976) where he emphasized that a "special instruction" of the New York Stock Exchange laid a duty on its members but not on their accountants.

It is concluded that the Trustee's first claim and the first, second, third, and fourth claims of SIPC must be dismissed for failure to state a claim upon which relief can be granted.

[428 F. Supp. 492]

7.

The other five claims of the Trustee are common law claims. The question is whether this Court has any jurisdiction of them. It seems clear that this Court has no jurisdiction.

Pendent jurisdiction will not justify retention of these claims. The federal claim of the Trustee in count one has been dismissed before trial and we are instructed that, in such event, "the State claims should be dismissed as well". *United Mine Workers* v. *Gibbs*, 383 U.S. 715, 726, 86 S. Ct. 1130, 16 L.Ed.2d 218 (1966)

The Trustee asserts an independent basis for jurisdiction under the general language of 11 U.S.C. § 11(a)(7).

The situation at bar, however, is controlled by 11 U.S.C. § 46 which provides that a trustee in bankruptcy may sue only in the courts where the bankrupt might have sued.

Section 6(c)(1) of SIPA (15 U.S.C. § 78fff(c)(1)) states in relevant part:

> "Except as inconsistent with the provisions of this chapter and except that in no event shall a plan of reorganization be formulated, a liquidation proceeding shall be conducted in accordance with, and as though it were being conducted under, the provisions of Chapter X and such of the provisions . . . of chapters I to VII, inclusive, of the Bankruptcy Act as section 502 of Title 11 would make applicable if an order of the court had been entered directing that bankruptcy be proceeded with pursuant to the provisions of such chapters I to VII, inclusive . . .".

Section 502 of Title 11 states in relevant part:

> "The provisions of chapters 1 to 7, inclusive of this title shall, insofar as they are not inconsistent or in conflict with the provisions of this chapter, apply in proceedings under this chapter: *Provided, however,* That section 46 . . . shall not apply in such proceedings unless an order shall be entered directing that bankruptcy be proceeded with pursuant to the provisions of chapters 1 to 7, inclusive." (emphasis in original)

Thus Section 46 of Title 11 is applicable to SIPA liquidations.

The arguments for the Trustee have been considered but cannot be accepted.

It may be mentioned that the Trustee urges a consent by Touche to the jurisdiction of this Court, a consent said to flow from the filing by Touche of a claim for professional services in the Weis liquidation. But the claim filed by Touche in the Weis liquidation was for accounting work in *European offices of Weis* in late 1972 and early 1973, as well as for a Stock Exchange audit as of April 27, 1973. The claim by the Trustee against Touche does not arise out of any work done for Weis by Touche and for which Touche filed a claim in the Weis liquidation. The claims are not "mutual" therefore but are unrelated and the consent of Touche cannot be found. *Cherno* v. *Engine Air Service, Inc.*, 330 F.2d 191 (2d Cir. 1964).

Under 11 U.S.C. § 46 we look to see whether Weis could have sued Touche in this Court. It seems undisputed that the principal place of business of Weis (28

U.S.C. § 1332(c)) was in New York and that members of the Touche firm are citizens of New York. Diversity jurisdiction would not exist of an action by Weis against Touche.

The second, third, fourth, fifth and sixth claims of the Trustee must be dismissed for lack of jurisdiction over the subject matter.

8.

The fifth, sixth, seventh, and eighth claims of SIPC are common law claims. As to these, SIPC argues for diversity jurisdiction on the ground that it should be considered for diversity purposes as a District of Columbia corporation. This argument cannot be accepted.

Under SIPA, SIPC was created as a corporation but it distinctly was *not* made a District of Columbia corporation. The relevant part of SIPA (15 U.S.C. § 78ccc(a)(3)) provides that SIPC is "subject

[428 F. Supp. 493]

to" the District of Columbia Nonprofit Corporation Act and has "all the powers" conferred on a nonprofit corporation by that Act. This does not mean, however, that it *is* a District of Columbia corporation. Note should be taken of the Act of Congress creating The American National Red Cross. Named persons are created "a body corporate and politic in the District of Columbia" (36 U.S.C. § 1a). For diversity purposes, the Red Cross is a citizen of the District of Columbia because the statutory language is specific, in marked contrast to that in SIPA. *Patterson* v. *Amer. Nat. Red Cross*, 101 F. Supp. 655 (S. D. Fla. 1951).

SIPC appears to be a federally created corporation which, like the American Legion (36 U.S.C. § 41), the

Disabled American Veterans (36 U.S.C. § 90a) and others, is not a citizen of any state for jurisdictional purposes. *Hancock Financial Corp.* v. *Federal Savings, etc.*, 492 F.2d 1325 (9th Cir. 1974); *Rice* v. *Disabled American Veterans*, 295 F. Supp. 131 (D. C. D. 1968).

There can be no jurisdiction simply because SIPC was created by Act of Congress because there is no stock ownership in SIPC by the United States. 28 U.S.C. § 1349.

Finally, the Trustee is a citizen of New York and is a plaintiff along with SIPC. Partners of Touche, the defendant, are citizens of New York. Thus, there is no complete diversity of citizenship within the rule of *Strawbridge* v. *Curtiss*, 3 Cranch 267, 2 L.Ed. 435 (1806).

The fifth, sixth, seventh, and eighth claims of SIPC must be dismissed for lack of jurisdiction over the subject matter.

Settle order and judgment on notice.

Dated: New York, New York
March 1, 1977

INZER B. WYATT
United States District Judge

Order and Judgment of the District Court

Filed March 15, 1977

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Plaintiffs,

—against—

TOUCHE ROSS & CO.

Defendant.

76 Civ. 1981 (I.B.W.)

ORDER AND JUDGMENT

Defendant having moved, pursuant to Rule 12(b), F.R.Civ.P., for an order dismissing this action, the complaint herein and each so-called cause of action therein alleged, and granting related relief, and the motion having been duly heard by the Court, and the Court having duly rendered its decision, dated March 1, 1977, granting the motion as hereinafter provided,

It is hereby ORDERED, ADJUDGED AND DECREED that

1. The first claim (called in the complaint "PLAINTIFF TRUSTEE'S FIRST CAUSE OF ACTION") of plaintiff Edward S. Redington, as Trustee for the liquidation of the business of Weis Securities, Inc. ("Redington"), and the first, second, third and fourth claims (called in the complaint, respectively, "PLAINTIFF SIPC'S FIRST CAUSE OF ACTION", "PLAINTIFF

SIPC'S SECOND CAUSE OF ACTION", "PLAINTIFF SIPC'S THIRD CAUSE OF ACTION", and "PLAINTIFF SIPC'S FOURTH CAUSE OF ACTION") of plaintiff Securities Investor Protection Corporation ("SIPC") are dismissed on the merits for failure to state a claim upon which relief can be granted;

2. The second, third, fourth, fifth and sixth claims (called in the complaint, respectively, "PLAINTIFF TRUSTEE'S SECOND CAUSE OF ACTION", "PLAINTIFF TRUSTEE'S THIRD CAUSE OF ACTION", "PLAINTIFF TRUSTEE'S FOURTH CAUSE OF ACTION", "PLAINTIFF TRUSTEE'S FIFTH CAUSE OF ACTION", and "PLAINTIFF TRUSTEE'S SIXTH CAUSE OF ACTION") of plaintiff Redington, and the fifth, sixth, seventh and eighth claims (called in the complaint, respectively, "PLAINTIFF SIPC'S FIFTH CAUSE OF ACTION", "PLAINTIFF SIPC'S SIXTH CAUSE OF ACTION", "PLAINTIFF SIPC'S SEVENTH CAUSE OF ACTION", and "PLAINTIFF SIPC'S EIGHTH CAUSE OF ACTION") of plaintiff SIPC are dismissed for lack of jurisdiction over the subject matter;

3. This action is dismissed, and defendant have judgment against plaintiffs, and each of them, dismissing this action.

New York, New York
March 15, 1977

/s/ INZER B. WYATT
U.S.D.J.

JUDGMENT ENTERED—3/15/77

/s/ RAYMOND F. BURGHARDT
CLERK

Opinion of the Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 136, 144—September Term, 1977.

(Argued November 14, 1977—Decided April 21, 1978.)

Docket Nos. 77-7183, 77-7186

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Plaintiffs-Appellants,

—v.—

TOUCHE ROSS & Co.,

Defendant-Appellee.

Before:

LUMBARD, MULLIGAN, and TIMBERS,

Circuit Judges.

Appeal from order of the Southern District of New York dismissing complaint. Inzer B. Wyatt, *J.*, ruled that neither SIPC nor broker's trustee in liquidation could maintain suit against accountant under section 17 of the Securities Exchange Act.

Reversed as to both plaintiffs and remanded.

JAMES B. KOBAK, JR., New York, N. Y. (Hughes Hubbard & Reed, John S. Allee, John W. Schwartz and Harold L. Kaplan, New York,

New York, on the brief), *for Plaintiff-Appellant Edward S. Redington, as Trustee for the liquidation of the business Weis Securities, Inc.*

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LUMBARD, *Circuit Judge:*

In this appeal, rising out of the insolvency and liquidation of the brokerage firm of Weis Securities, Inc. ["Weis"], we are presented with the question whether a private cause of action exists under section 17 of the Securities Exchange Act of 1934[1] against account-

[1] 15 U.S.C. § 78q (1976). This section was amended in 1975; in 1972, the date relevant to the instant case, it read, in relevant part:

(a) Every national securities exchange, every member thereof, every broker or dealer who transacts a business in securities through the medium of any such member, every registered securities association, and every broker or dealer registered pursuant to section 15 of this title, shall make, keep, and preserve for such periods, such accounts, correspondence, memoranda, papers, books, and other records, and make such reports, as the Commission by its rules and regulations may prescribe as necessary or appropriate in the public interest or for the protection of investors. Such accounts, correspondence, memoranda, papers, books, and other records shall be subject at any time or from time to time to such reasonable periodic, special, or other examinations by examiners or other representatives of the Commission as the Commission may deem necessary or appropriate in the public interest or for the protection of investors.

ants who prepare misleading statements of a broker's financial affairs, and if so, who may maintain such an action.

The district court dismissed the claims herein of the Securities Investor Protection Corp. ["SIPC"][2] and of Edward S. Redington, Weis' Trustee in Liquidation ["Trustee"], believing that no claim for relief was stated because no cause of action could be implied from section 17.[3] *Redington* v. *Touche Ross & Co.*, 428 F. Supp. 483 (S.D.N.Y. 1977). We conclude that customers of a broker have a right of action against an accountant whose audits of the brokerage firm are false or misleading. Because we believe that SIPC and the Trustee are appropriate parties to seek (between them) total recovery of the customers' damages, we reverse and remand.

I

Touche Ross & Co. ["Touche Ross"] served as Weis' independent certified public accounting firm from 1969 to 1973. In that capacity, Touche Ross prepared annual audits of Weis' affairs as required by section 17 and regulations thereunder.

The complaint herein alleged that during fiscal 1972, certain of Weis' officers conceived and executed a scheme to conceal from the regulatory authorities and

[2]SIPC was created by the Securities Investor Protection Act of 1970, Pub. L. No. 91-598, 91st Cong., 2d Sess., 84 Stat. 1636, *codified at* 15 U.S.C. §§ 78aaa-78*lll* (1976).

[3]Our decision in this case has been materially aided by the brief *amicus curiae* submitted on appeal by the SEC. Judge Wyatt did not have the advantage of the SEC's position in this matter.

Judge Wyatt also dismissed, for lack of subject matter jurisdiction, five state common-law claims which the Trustee had sought to bring under principles of plenary bankruptcy or pendent jurisdiction, and four state common-law claims by SIPC, with respect to which diversity of citizenship had been alleged. Judge Wyatt ruled that SIPC was not a District of Columbia corporation for purposes of jurisdiction, and that complete diversity did not exist. Because of the view we take of the case, we need express no opinion as to the scope of bankruptcy jurisdiction in SIPA-receivership cases, nor as to the citizenship of SIPC.

the public Weis' dire financial condition.[4] The elements of this scheme appear in great detail in the complaint; for example, although Weis had suffered a loss for fiscal 1972 of greater than $1.5 million, its pre-tax earnings for that year were stated as being around $1.7 million.

When Weis' fiscal 1972 ended on May 26, 1972, Touche Ross proceeded to prepare and certify Weis' financial statements, and to answer the financial questionnaire required by the New York Stock Exchange of its member firms. In four opinion letters, dated July 7, July 7, July 21 and July 21 (all of 1972), Touche Ross represented that it had examined (i) the statement of Weis' current financial condition; (ii) Weis' answers to the financial questionnaire; (iii) Weis' consolidated balance sheet for the past year; and (iv) Weis' consolidated statement of earnings for the past five years, and found that each presented fairly and accurately the financial picture of Weis, in conformity with generally accepted accounting procedures.

In fact, Weis' financial condition was not as stated in the above four documents, but was far more precarious. As no steps were taken to attempt to remedy Weis' situation, it continued to deteriorate.[5] On May 24, 1973, the SEC sought an injunction preventing Weis and its officers from continuing to violate the '34 Act, and SIPC applied for a decree, pursuant to 15 U.S.C. § 78eee(a)(2), adjudging Weis' customers in need of protection under SIPA. Accordingly, Weis' liquidation was ordered by (then) District Judge Gurfein on May 30,

[4]In this posture of the case, we take—as we must—that view of the facts most favorable to plaintiffs, treating as true the allegations of the complaint. *See Escalera* v. *New York Housing Auth.*, 425 F.2d 853, 857 (2d Cir. 1970).

[5]Plaintiffs contend that the misleading statements certified by Touche Ross were the direct cause of the failure to take any remedial action, such as an infusion of capital or merger with another firm. Thus, they assert, Touche Ross' dereliction substantially contributed to Weis' forced liquidation and plaintiffs' losses. These contentions will be discussed more thoroughly in the body of the opinion.

1973, and Edward Redington was appointed Trustee for the liquidation.

SIPC and the Trustee jointly began an action against Touche Ross in New York state court on July 3, 1975. *Redington* v. *Touche Ross & Co.*, No. 13996/76 (Sup. Ct. N. Y. County). The common allegations of the plaintiffs in the state court complaint were the same as those in the instant case, except that three paragraphs dealing with claims under section 17 of the '34 Act were omitted. Five of the Trustee's six present "causes of action" appear in identical form in the state action, as do four of SIPC's eight present claims. The additional claims in this action are the federal securities law claims.

The instant suit was commenced on April 30, 1976. Under federal law and state common law, SIPC seeks to recover $14 million, either as subrogee of Weis' customers whose claims it has paid under SIPA, or as a member of the group directly injured by Touche Ross' delicts. Likewise under federal law and state common law, the Trustee is claiming $51 million; he contends that he may recover either by standing in the shoes of Weis' customers, since under SIPA, his is the responsibility to marshal and return their property,[6] or by standing in the shoes of Weis itself, since, he alleges, Weis—as an entity distinct from its conniving officers—was directly damaged by Touche Ross' unsatisfactory audit.

SIPC and the Trustee appeal from Judge Wyatt's order dismissing the complaint for failure to state a claim on which relief could be granted (with respect to the section 17 counts). Touche Ross asks us, in the event we reverse, to stay the federal action in favor of the state

[6]Property on hand when Weis was liquidated permitted the Trustee to return to customers 67% of the property they should have received. In addition, SIPC paid out some $14 million to customers and other creditors. Since under 15 U.S.C. § 78fff (1976), accounts are protected only up to $20,000 in cash and $50,000 in cash and securities, there may remain customers with uncompensated losses, who therefore retain claims against those who caused their losses. It is these claims that we hold the Trustee may assert. *See* part III B *infra*.

court suit.[7] This last issue, evidently, is one which Judge Wyatt has never had cause to consider.

II

The first question we address is whether customers of a brokerage firm are given any remedy by the '34 Act against accountants whose section 17 reports are false or misleading. There are two major considerations involved in this decision: the criteria laid down by the Supreme Court in *Cort* v. *Ash*, 422 U.S. 66 (1975), for finding an implied right of action in a statute which is silent on the issue; and the "purchase or sale" requirement reaffirmed by the Court in *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975).

One preliminary matter must be dealt with. Judge Wyatt held that section 17 "was designed to supply administrative guidance in the bookkeeping area and not to create rights in anybody," and that it "does not impose any duty on accountants." 428 F. Supp. at 489, 491. We believe that, even if no right of action were implied, to see nothing but "administrative guidance" in a provision as crucial to the regulation of brokers as section 17 is to take far too narrow a view of the statute. Certified public accountants play a significant role in the scheme created by the '34 Act for the regulation of securities trading, as is recognized by the regulations promulgated by the SEC.[8] *See, e.g.*, 17 C.F.R. § 240.17a-5(b), (f), (g), (h), (i), (m). It is well established that section 10(b) of the '34 Act and rule 10b-5

[7]Plaintiffs aver that the state court action was commenced first only in a highly technical sense. It was begun by service of a summons without complaint (the complaint was not served until after the filing of the federal complaint), and then apparently ignored for some months by mutual consent. The parties agree that the state suit has progressed to the extent of responses by each plaintiff to one set of defendant's interrogatories.

[8]For a discussion of the functions and duties of accountants in this context, see *In re* Touche, Niven, Bailey & Smart, 37 S.E.C. 629, 5 Fed. Sec. L. Rep. (CCH ¶72,100, at 62,212 (1957); Note, *Accountants' Liability for False and Misleading Financial Statements*, 67 Colum. L. Rev. 1473 (1967).

thereunder impose a duty on accountants, for breach of which they may be sued. *See Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976). We hold that section 17 of the '34 Act likewise imposes a duty on accountants.

A

The factors cited in *Cort* v. *Ash, supra,* 422 U.S. at 78, familiar through much repetition, which bear on the propriety of finding an implied right of action in a statute are:

> 1) Whether plaintiffs belong to the class for whose special benefit the statute was enacted;
>
> 2) Whether there is any indication of legislative intent on the issue;
>
> 3) Whether implication of a right of action is consistent with the policies behind the legislative scheme; and
>
> 4) Whether the cause of action in question is one traditionally relegated to state law.

A consideration of these four factors convinces us that implication of a right of action in favor of Weis' customers is appropriate.

1. The language of section 17, the SEC rules in the 17a-5 series, and an analysis of the role played by accountants' reports in the regulation of brokers make clear the extent to which Weis' customers are members of a class peculiarily protected by section 17.

The documents and reports that the SEC is empowered to require of brokers must be "necessary or appropriate in the public interest *or for the protection of investors*." 15 U.S.C. § 78q(a) (emphasis added). The

same is true of the examinations that the SEC is empowered to conduct. *Id.*[9]

In order to provide a complete and accurate picture of a broker's financial condition, the SEC requires that the broker enlist an independent accountant to audit and certify its statements, list any matters to which the accountant takes exception, and provide certain additional financial data. Rule 17a-5(b), (i) (k). Furthermore, a notice of any "material inadequacies" found by the accountant in the broker's procedures must be sent to the broker's customers. Rule 17a-5(m)(3).[10]

The function of this arsenal of financial reports is to protect the broker's customers. One of the main methods adopted by the SEC to shield customers is the net capital rule, in either the form promulgated by the SEC, rule 15c3-1, or the stricter version enforced by the New York Stock Exchange, Exchange Rule 325.

The net capital rule is a requirement that a broker maintain a certain minimum ratio of liquid assets to aggregate indebtedness; its "principal purpose . . . is to require that the capital position of a broker . . . will always be sufficiently liquid to cover his current indebtedness, in order to be able at all times to promptly meet [sic] the demands of customers." Exchange Act Release No. 8024, 6 Fed. Sec. L. Rep. (CCH) ¶ 72,129 (1967). As amended in order to take into account the creation of SIPC, the rule serves particularly to "protect customers prior to the time when the broker's . . . assets would be sufficient to satisfy customers in the event of liquida-

[9]In 1957, when the SEC expanded certification requirements for section 17 reports,

> that step represented the Commission's considered view that certification and reporting requirements constituted a valuable regulatory tool for the protection of a customer in respect of the risks involved in leaving his money and securities with his broker-dealer.

SEC, *Study of Unsafe and Unsound Practices of Brokers and Dealers,* H. Doc. No. 92-231, 92d Cong., 1st Sess., at 24 (1971).

[10]Citations to rule 17a-5 are to 17 C.F.R. § 240.17a-5 as it existed in 1972. Rule 17a-5(j)-(o) were adopted on June 30, 1972, and appear in the *Federal Register* for July 21, 1972.

tion." Exchange Act Release No. 11,497, [1975-76 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,212.

It is the reporting system created by section 17 that provides the SEC and other regulatory authorities with the information needed to enforce the net capital rule. Thus, a failure to supply accurate reports will leave the customers without protection until the broker's insolvency can no longer be concealed, and liquidation follows.

2. We find no indication, either in the statute itself or in its legislative history, of any congressional intent either to create a private remedy under section 17 or to deny one.[11]

The legislative history of the section is mute on the issue, leading to the conclusion that Congress never *explicitly* considered the question. Nor can it be said that Congress *implicitly* chose to deny a private right of action; section 17 is distinctly different in an important respect from statutes as to which such implicit intent has been found.

In *SIPC* v. *Barbour*, 421 U.S. 412 (1975), the Supreme Court noted that SIPA manifested a specific legislative intent to restrict enforcement to the SEC. *Id.* at 420, 425. In *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers*, 414 U.S. 453, 458 (1974), a similar exclusivity was found to rest with the Attorney General; in *Cort* v. *Ash* itself, *supra*, 422 U.S. at 74-76, the Federal Election Commission was held to be the agency charged with exclusive enforcement.

We have recently indicated that an intent to commit enforcement of the securities statutes exclusively to the SEC will not readily be implied. *Abrahamson* v. *Fleschner*, 568 F.2d 862, 874 n.19 (2d Cir. 1977).

[11]To the extent that the court below relied on the remedy created by section 18 of the '34 Act as evidence of a legislative intent to deny a private remedy for violations of section 17, its concerns will be treated in part II B *infra*.

Nothing in section 17 induces us to treat it as an exception to this rule.

3. "Absent specific statements of legislative intent, we must examine the legislative purposes underlying the Act." *Abrahamson* v. *Fleschner, supra*, 568 F.2d at 874, conclude that a private right of action under section 17 is consistent with those purposes.

A partial list of the many sections of the securities acts under which private remedies have been implied appears in *Franklin National Bank* v. *L. B. Meadows & Co.*, 318 F. Supp. 1339, 1341-42 (E.D.N.Y. 1970). *See* III L. Loss, Securities Regulation 1785 (2d ed. 1961). At least since *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964) (section 14(a)), it has been accepted in securities law that when a statutory provision imposes a duty on someone in favor of a class of protected persons; those persons may sue for the 'statutory tort' committed when the duty is breached.

We have held that section 17 imposes a duty on accountants in favor of brokers' customers. We note that—just as in *Borak*—the SEC was not meant to, and does not have the resources to examine and audit all the documents that it receives (in *Borak*, proxy statements; here, section 17 reports).[12] Both it and SIPC, as well as the broker's customers must rely on the certification by the accountants.

Neither SEC injunctive actions nor criminal prosecutions will restore to customers the money they have lost. Indeed, the cases cited by Judge Wyatt in support of the proposition that there exists injunctive and criminal relief for violations of section 17 do not involve

[12]In its *amicus* brief, the SEC advises us that, in fiscal 1976, over 5000 brokers and dealers were registered with it; that each of the approximately 750 broker-dealers that are not members of self-regulating organizations must be audited annually, as must the 500 or so against whom complaints are lodged; and that this leaves the SEC able to examine each year the statements of only 5% of broker-dealers who are apparently untroubled members of self-regulatory organizations.

accountants. *See* 428 F. Supp. at 490, and cases cited. Accordingly, we rule that a private remedy is an essential supplement to the scheme of enforcement of section 17.

4. Finally, it is evident that just as the problems caused by insolvent brokers are national in scope, so must be the standards governing their reporting. Section 17 is part of a statute as to which federal courts have exclusive jurisdiction; state law protection of brokers' customers varies widely. There is no reason to believe that the remedy sought herein is one traditionally relegated to state law.

B

The court below found a particularly high barrier to plaintiffs in section 18 and the judicially created purchaser-seller doctrine. 428 F. Supp. at 489-90. Section 18 creates private remedy for "misleading statements" in "any application, report, or document filed pursuant to this chapter," in favor of "any person . . . who . . . shall have purchased or sold a security at a price which was affected by such statement. . . ." 15 U.S.C. § 78r.

Applying this language, and the holding of *Blue Chip Stamps, supra,* 421 U.S. at 736, Judge Wyatt ruled that the remedy provided by section 18 was exclusive, and that thus no remedy existed for brokers' customers injured as a result of an accountant's misleading statements, absent a purchase or sale of an affected security. We disagree.

Since any misstatement in a section 17 report would not affect the price of the shares of the various issuers in the hands of a broker's customers, a strict application of section 18's limiting language would leave customers without any remedy whatsoever, no matter how egregious the fraud or how grievous their loss. Yet it is plain that brokers' customers are favored wards of section 17. We cannot agree that Congress simultaneously sought to protect a class and deprived the class of the means of protection.

Our holding is not inconsistent with either the purchaser-seller limitation or section 18, which will continue to apply to all investors in market securities who seek relief *qua* investors. That is, the *Blue Chip* doctrine would bar a suit by an investor who claimed to have been induced *not* to purchase or sell by a misstatement. We do not believe, however, that the doctrine applies to brokers' customers, protection of whom is wholly independent of protection of investors per se.

III

In light of the foregoing analysis, we decide that brokers' customers have a right of action against accountants for certifications that violate the standard set by section 17 and rule 17a-5. This does not, however, resolve the question whether the plaintiffs in the instant case, SIPC and the Trustee, are proper parties to bring the action.

A

SIPC asserts a right to bring this action both in its own right and as subrogee of the customers whose claims it has paid. We hold that SIPC may maintain the action as subrogee.[13]

SIPA provides expressly that SIPC, upon reimbursing a customer's losses, shall be subrogated to that customer's claims against the debtor's (here Weis')

[13]We need not reach the question whether SIPC could ever have a claim for damages other than on behalf of a broker's customers; we only note that as the creature of a 1970 statute, SIPC can hardly claim to have been a specially protected beneficiary of the '34 Act. SIPC makes much of 15 U.S.C. § 78bbb (1976), which treats SIPA as if it "constituted an amendment to, and was included as a section of" the '34 Act. Nonetheless, it is indisputable that SIPC is not the kind of entity Congress sought to protect either in 1934 or in 1970; the cited portion of the 1970 statute appears to do no more than indicate that, except where specifically provided otherwise, any remedy created by SIPA is supplemental to the preexisting remedies of the '34 Act.

estate. 15 U.S.C. § 78fff(f)(1). Touche Ross contends that SIPC's statutory right of subrogation against the debtor's estate is its exclusive remedy, precluding any rights against third parties such as Touche Ross. We disagree.

Section 78fff is a detailed blueprint for the distribution of the liquidated debtor's estate, and it is to be expected that SIPC's rights against the estate would be included in that section. However, there is no reason to believe that this was meant to destroy SIPC's general common-law right of equitable subrogation.

> [T]he general rule is that upon payment of a loss the insurer is entitled to be subrogated pro tanto to any right of action which the insured may have against a third person whose negligence or wrongful act caused the loss.

31 N.Y. Jur., *Insurance* § 1620, at 510. *See Ackerman* v. *Motor Vehicle Accident Indemnification Corp.*, 18 App. Div. 2d 307, 239 N.Y.S.2d 463 (1st Dept. 1963) (explicit statutory provision did not destroy MVAIC's broader common-law right to subrogation).

Moreover, we believe that it is more in keeping with the intent of Congress that wrongdoers not receive a windfall benefit from the existence of SIPC, and that SIPC be able to recoup its losses from solvent wrongdoers. Accordingly, we find that SIPC is subrogated to the right of action implied in section 17 in favor of brokers' customers against third parties such as accountants. *See SEC* v. *Albert Maguire Securities Co.*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 96,129, at 92,076 (3d Cir. July 27, 1977).

B

The Trustee contends that he is a proper plaintiff herein, both as the representative of Weis' estate and as bailee of Weis' customers' property. We hold that he may maintain this action on behalf of such customers as have not been fully reimbursed by SIPC.

The barriers to a right of action on Weis' behalf are insurmountable. It is apparent that brokers, such as Weis, were not included in the class of those *protected* by section 17; indeed, brokers are the very entities *regulated* by section 17.

Two recent cases in point are *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1 (1977), and *Lank* v. *New York Stock Exchange*, 548 F.2d 61 (2d Cir. 1977). In each, a member of the class sought to be regulated by Congress attempted to claim the benefit of an implied right of action under the very statute that regulated it. *Chris-Craft* held that a defeated tender offeror could not enforce the Williams Act, 15 U.S.C. § 78o(e), against a successful tender offeror, because "a party whose . . . conduct was purposefully brought under federal control by the statute . . . can scarcely lay claim to the status of 'beneficiary' whom Congress considered in need of protection." 430 U.S. at 37.

In *Lank*, we decided, in a case not unlike the instant case, that the receiver of a liquidated brokerage firm could not—because the firm itself could not—sue a securities exchange for failure to force the firm to comply with the exchange's rules. We pointed out that the '34 Act did not afford protection "to the very members of the stock exchanges whose conduct was being regulated." 548 F.2d at 66. The extent to which *Lank* parallels the instant case precludes our holding that the Trustee may maintain this action on Weis' behalf.

However, none of the above considerations apply to an action brought by the Trustee as bailee of the property of Weis' customers. He is responsible for marshalling and returning their property; to the extent that he is unable to do so, he argues, he may sue on behalf of the customer/bailors any wrongdoer whom they could sue themselves.

Rule 17(a) of the Federal Rules of Civil Procedure reads, in part: "[A] . . . bailee . . . may sue in his own name without joining with him the party for whose

benefit the action is brought. . . ." The Advisory Committee Notes to this section, added in 1966,[14] point out by way of illustration that the "owner of a warehouse in which household furniture is stored is equally entitled to sue on behalf of the numerous owners of the furniture stored." 39 F.R.D. 69, 85 (1966). *See generally* 5 N.Y.Jur., *Bailments* §§ 118, 119.

To the extent that customers have claims that have not been satisfied either by Weis in liquidation, *see* note 6 *supra,* or by SIPC, they retain rights of action against Touche Ross. We hold that the Trustee, as bailee, is an appropriate real party in interest to maintain this action on their behalf.

IV

Since we hold that both SIPC and the Trustee may maintain this action against Touche Ross, we remand to the district court for further proceedings consistent with this opinion. We leave to it in the first instance a number of questions that will now arise: whether to stay the federal action pending determination of the state action;[15] whether to exercise pendent jurisdiction over the plaintiffs' common-law claims; and what the appropriate standard is for accountant liability in actions under section 17, *cf. Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976).

Reversed and remanded.

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[14]The purpose of the 1966 amendment was "[to] add to the illustrative list of real parties in interest a bailee—meaning, of course, a bailee suing on behalf of the bailor with respect to the property bailed." 39 F.R.D. 69, 84 (1966).

[15]In *Weiner* v. *Shearson, Hammill & Co.,* 521 F.2d 817 (9th Cir. 1975), the court of appeals chose to remand the question of a stay to the district court, despite its thorough discussion of the factors involved in the determination of the question.

TIMBERS, *Circuit Judge,* concurring:

I concur in all respects in Judge Lumbard's clear, concise and, in my view, correct majority opinion.

In view of the characteristically thoughtful and earnest dissent of our Brother Mulligan, however, I should like to add a few words, partly to supplement Judge Lumbard's opinion, but chiefly to suggest that Judge Mulligan's dissent be read in the light of the following observations.

First, in urging that customers of a broker-dealer in liquidation have no implied right of action for damages under Section 17 of the Exchange Act against accountants who prepare false or misleading reports required by that statute, the dissent understandably is disturbed by the *unanimous* opinion in *Cort* v. *Ash,* 422 U.S. 66, 78 (1975), as recently reaffirmed in *Piper* v. *Chris-Craft Industries, Inc.,* 430 U.S. 1, 37-45 (1977). Granted that the dissent's massive effort to distinguish or to apply a gloss to *Ash* is an artful attempt to circumvent this key decision, I fear that our dissenting colleague has misapprehended the essential purpose of *Ash* in stating certain factors to be taken into consideration in determining whether to imply a right of action under a given statute. The dissent at the outset, *post,* at , emphasizes that *Ash* is not relevant to a case which arises under a statute which expressly provides for a private right of action. This overlooks the fact that the Supreme Court specifically applied the *Ash* analysis in *Piper, supra,* 430 U.S. at 37-41, in determining whether a private remedy was implicit in Section 14(e) of the same statute with which we are here concerned, i.e. the Exchange Act. Assuming that what the dissent intends to emphasize, *post,* at , is that *Ash* does not apply when an *express remedy* is provided for the *specific wrong* complained of, it must be remembered that the Court reaffirmed the implication of a private right of action under Section 10(b) of the Exchange Act and Rule 10b-5 promulgated

thereunder in *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 730 (1975), despite the absence of legislative history on the subject, *id.* at 737, much less "clear contrary evidence of legislative intent." *Post*, at .

Second, the dissent's displeasure with *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964), likewise is understandable. This seminal opinion written by the late Mr. Justice Tom Clark for a *unanimous* Supreme Court, in holding that Section 27 of the Exchange Act provided the jurisdictional underpinning for an implied private right of action for damages (as well as for declaratory and equitable relief) arising from violations of Section 14(a) of the Exchange Act, *id.* at 430-35, expressly recognized that "Private enforcement of [Commission rules] provides a necessary supplement to Commission action", *id.* at 432, and, that "[I]t is the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose." *Id.* at 433. Despite our Brother Mulligan's herculean effort in dissent to buttress his assertion that *Borak* "has been significantly restricted by more recent decisions of the Supreme Court", *post*, at , those decisions strike me as expressly and emphatically reaffirming the *Borak* rule[1]—as Mr. Justice Stevens stated in *Piper, supra*, 430 U.S. at 67, "*Borak* remains a viable precedent."

Third, the dissent speaks disparagingly of the SEC amicus brief. *Post*, at 2725 n.1. As Judge Lumbard correctly points out, *ante*, at 2707 n.3, we were aided materially by the SEC brief, whereas the district court did not have the advantage of knowing of the SEC's position. Here again, our Brother Mulligan's attempt to disparage the SEC brief is understandable, for it urges forcefully and cogently that SIPC should be permitted to assert a private right of action under Section 17 of the

[1]For example, in *Piper, supra*, 430 U.S. at 25, Chief Justice Burger stated:

> "This Court has nonetheless held that in some circumstances a private cause of action can be implied with respect to the 1934 Act's antifraud provisions, even though the relevant provisions are silent as to remedies. *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964) (§14(a)); *Superintendent of Ins.* v. *Bankers Life & Cas. Co.*, 404 U.S. 6, 13 n. 9 (1971) (§10(b))."

In *SIPC* v. *Barbour*, 421 U.S. 412, 417 (1975), referring to *Borak*, Mr. Justice Marshall summarized its holding:

> "In light of the 'broad remedial purposes' of the Act and the SEC's representation that private enforcement was necessary to effectuate those purposes, the Court held that the action for damages could be maintained."

And in *Blue Chip Stamps, supra*, 421 U.S. at 730, after summarizing the 25 year development of the decisional law that there is an implied private right of action under Rule 10b-5, Mr. Justice Rehnquist, referred to *Borak* as follows:

> "Such a conclusion was, of course, entirely consistent with the Court's recognition in *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 432 (1964), that private enforcement of Commission rules may '[provide] a necessary supplement to Commission action.'"

These decisions do not strike me as significantly "restricting" *Borak;* rather, they seem quite clearly to reaffirm *Borak* as a "viable precedent", each case turning of course on the particular statute or rule under consideration.

Exchange Act under the circumstances of this case. But far more basic than whether the SEC as amicus supports or opposes one side or the other in litigation under the federal securities laws, *is that the position of the SEC should be known to the court.* That is the point of Judge Lumbard's observation referred to above. And it is especially important in a case of first impression such as the instant one involving a statute under which Congress has imposed on the Commission specific responsibilities.[2] Wholly aside from the instant case—where I find the

[2]Section 7 of SIPA, 15 U.S.C. §78ggg (1976). See *SIPC* v. *Barbour, supra*, 421 U.S. at 417.

The SEC cogently summarizes in its brief filed in our Court its interest in the instant appeal as follows:

> "The Commission respectfully submits this brief as *amicus curiae* because this appeal raises significant issues which could materially affect its administration of the federal securities laws. We believe . . . that permitting a private right of action under Section 17 of the Securities Exchange Act will provide a necessary supplement to the Commission's efforts to enforce that section and the rules and regulations thereunder. In addition, financial statements submitted by broker-dealers

SEC amicus brief to measure up to the Commission's high standard of competence and fairness—I do hope that our Brother Mulligan's disparagement of the SEC amicus brief will not be construed as a judicial signal, even in dissent, that the Commission should retreat to its position of a generation ago which drew sharp criticism from our Court. *Compare Blau* v. *Mission Corp.*, 212 F.2d 77, 81 (2 Cir.), *cert. denied*, 347 U.S. 1016 (1954), and *Roberts* v. *Eaton*, 212 F.2d 82, 84 (2 Cir.), *cert. denied*, 348 U.S. 827 (1954), *with Studebaker* v. *Gittlin*, 360 F.2d 692, 695 (2 Cir. 1966), and *Greene* v. *Dietz*, 247 F.2d 689, 695-98 (2 Cir. 1957) (concurring and dissenting opinions; per curiam opinion on rehearing). *See Some Practical Aspects: The SEC and The Federal Judiciary*, 41 A.B.A.J. 1136, 1137-38 (1955).[3]

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pursuant to the Act play a key role in the Commission's administration and enforcement of various statutory provisions designed to protect against loss of the funds and securities of customers of broker-dealers and to maintain confidence in the securities markets at a high level. The availability of a right of action under Section 17 will thus have a direct bearing on the overall effectiveness of such statutory and regulatory provisions as those regarding hypothecation and segregation of securities and cash, and the net capital rule, designed to ensure the ability of brokers to meet their financial obligations as custodians of customer property. In addition, the Commission has 'plenary authority' with respect to the operations of the Securties Investor Protection Corporation, and is therefore concerned that SIPC have the ability to recover funds needlessly expended due to the wrongful acts of others, thus preserving the funds available to compensate losses suffered by the customers of brokers." (footnotes omitted). SEC Amicus Curiae Brief, filed August 31, 1977, at 3-4.

[3]I am pleased to note that, in response to my concurring opinion, Judge Mulligan very commendably has disclaimed any intention to disparage the SEC amicus brief below, n.1, last paragraph. This reflects the good judgment and fairness for which our distinguished colleague is well known. As a former Dean of the Fordham Law School, I think that Judge Mulligan would join in taking judicial notice of one of the leading expositions of the history and functions of the amicus curiae through centuries of development of the law. Beckwith and Sobernheim, Amicus Curiae—MINISTER OF JUSTICE. 17 Fordham Law Review 38 (1948).

Accordingly, after carefully considering Judge Mulligan's dissenting opinion, especially in the light of the observations set forth above, I concur without qualification in Judge Lumbard's majority opinion.

MULLIGAN, *Circuit Judge* (dissenting):

In my view this case was properly decided by Judge Wyatt and the order and judgment dismissing the complaint should be affirmed.[1] The majority announces that "[a]t least since *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964) . . . it has been accepted in securities law that when a statutory provision imposes a duty on someone in favor of a class of protected persons, those persons may sue for the 'statutory tort' committed when the duty is breached." Majority opinion at 2715. The *Borak* rule, which liberally implied private actions in federal regulatory acts on a statutory tort theory, has been significantly restricted by more recent decisions of the Supreme Court which are misapplied by the majority opinion.[2]

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[1]The majority comments in footnote 3 that its decision has been materially aided by the brief *amicus curiae* submitted on appeal by the SEC and that Judge Wyatt did not have the advantage of the SEC's position in this matter. The Supreme Court, however, in *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1. 41 n.27 (1977) observed that ". . . its [the SEC's] 'expertise' in the securities-law field is of limited value when the narrow legal issue is one peculiarly reserved for judicial resolution, namely whether a cause of action should be implied by judicial interpretation in favor of a particular class of litigants." That, of course, is the principal issue in this case as well. It should also be added that a substantial part of the SEC brief is devoted to the argument that SIPC in its own right may assert a private right of action for violations of section 17 of the '34 Act. This proposition was not only rejected below but was repudiated by the majority in its footnote 13.

I do not "disparage", as my Brother Timbers would have it, the brief of the SEC. I simply do not agree with it—neither does the majority, at least to the extent I have indicated. Nor do I dispute the propriety of its submission. I cannot believe that disagreement with the opinions of any agency can sensibly discourage the filing of a brief expressing its views as *amicus curiae (sed non parens curiae)*. It remains the function of the bench to construe the law as best it can even though that involves on occasion disagreement with one's colleagues or even an agency.

[2]These decisions discussed in the text, *infra*, include *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1 (1977), *Cort* v. *Ash*, 422

While the majority purports to consider the factors set forth in *Cort* v. *Ash*, 422 U.S. 66 (1975), it must be emphasized that Justice Brennan in his opinion in *Cort* carefully restricted their application: "In determining whether a private remedy is implicit in a statute *not expressly providing one*, several factors are relevant." 422 U.S. at 78 (emphasis supplied). In *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1, 37 (1977) Chief Justice Burger's opinion similarly confined the *Cort* factors, noting that they are " 'relevant' in determining whether a private remedy is implicit in a statute *not expressly providing one*." (Emphasis supplied).

In the instant case, however, we are confronted with a statute for which Congress has clearly provided a remedy in the event of certain violations. Admittedly, section 17(a), set forth in footnote 1 of the majority opinion, does not itself include any private remedy for an infraction of its terms. It simply requires that brokers or dealers such as Weis, make, keep and preserve records and make such reports as the SEC may prescribe by its rules and regulations in the interest of the public and for the protection of investors. Other comparable sections of the '34 Act (the Act) also provide for the filing of reports. See sections 13(a), 15 U.S.C.§ 78m(a); 13(d), 15 U.S.C.§ 78m(d); 13(f), 15 U.S.C. § 78m(f); and 15

U.S. 66 (1975); *Securities Investor Protection Corp.* v. *Barbour*, 421 U.S. 412 (1975); *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers*, 414 U.S. 453 (1974) *(Amtrak)*; see *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975). Numerous commentators have acknowledged the substantial retreat from *Borak* represented by these subsequent Supreme Court rulings. E.g., Climan, Civil Liability Under the Credit-Regulation Provisions of the Securities Exchange Act of 1934, 63 Cornell L. Rev. 206, 261-69 (1978); Comment, Implying Private Causes of Action From Federal Statutes: *Amtrak* and *Cort* Apply the Brakes, 17 B.C. Ind. & Com. L. Rev. 53, 64 (1975); Comment, Private Rights of Action Under *Amtrak* and *Ash:* Some Implications for Implication, 123 U. Pa. L. Rev. 1392, 1416 (1975); Note, Implication of Private Actions from Federal Statutes: From *Borak* to *Ash*, 1 J. Corp. Law 371 (1976); 30 Vand. L. Rev. 905, 908-10 (1977).

(a), 15 U.S.C. § 78o(d). Like section 17(a), these sections include in their text no provisions for a private remedy.

Section 17 is immediately followed, however, by section 18(a), 15 U.S.C. § 78r(a), entitled "Liability for Misleading Statements" which does provide an express private remedy for violation of the reporting provisions of the Act. It states:

> Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to [the '34 Act] or any rule or regulation thereunder . . . , which statement was . . . false or misleading with respect to any material fact, shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have *purchased or sold a security* at a price which was affected by such statement, for damages caused by such reliance unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading.

(Emphasis supplied).

Section 18(a) follows upon the heels of section 17. Its subject matter covers reports or documents filed pursuant to the '34 Act and regulations promulgated thereunder. Thus, Judge Wyatt correctly found and, indeed, common sense would dictate, that section 18(a) expressly provides the sole private remedy which Congress intended to be available for a violation of section 17(a) and the other reporting sections of the '34 Act. Furthermore, most courts which have considered the issue have found section 18(a) to contain the only remedy for violation of the Act's reporting sections.[3]

[3] *Meer* v. *United Brands Co.*,[1976-77 Transfer Binder] CCH Fed. Sec. L. Rep. ¶95,648 at p. 90,213 (S.D.N.Y. 1976); *duPont* v. *Wyly*, 61 F.R.D. 615, 628 (D. Del. 1973); *In re Penn Central Securities Litigation*, 347 F.Supp. 1327, 1340 (E.D. Pa. 1972),

It seems clear, then, that the statutory scheme enacted by Congress provides in section 18(a) an express but limited remedy for violations of section 17(a). As noted above, the Supreme Court has repeatedly limited use of the *Cort* factors to instances in which *no* statutory remedy whatsoever has been provided. Hence, it must seriously be questioned whether the *Cort* factors are even the appropriate analytical tool to determine whether an implied private right of action should exist for infractions of section 17(a). Nonetheless, using a *Cort* analysis the majority finds an implied private damage remedy because it determines that brokers' customers are "favored wards" of, and a class "peculiarly protected" by section 17. Therefore, states the majority, we cannot assume that the Congress intended to deprive them of "the means of protection." Majority opinion at 2716.

I believe the majority reasoning is faulty in two major respects. In the first place, if the brokers' customers were so clearly the concern of the Congress when it enacted section 17(a), its failure to afford them a private damage remedy in section 18(a), which was contemporaneously enacted and which provides a private remedy for misleading statements in reports filed pursuant to the mandate of the Act, leads to the conclusion that Congress did not intend a private damage remedy to be available to brokers' customers.

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relevant point adhered to on reargument, 357 F.Supp. 869 (E.D. Pa. 1973), aff'd, 494 F.2d 528, 539-40 (3d Cir. 1974); see *Myers* v. *American Leisure Time Enterprises, Inc.*, 402 F.Supp. 213, 214 (S.D.N.Y. 1975), aff'd without opinion, 538 F.2d 312 (2d Cir. 1976). But see the district court cases discussed in *In re Penn Central Securities Litigation, supra,* 494 F.2d at 540 n.18.

It should be noted that in a case related to that at bar the customers of Weis brought a class action against Touche Ross alleging, *inter alia,* that Touche Ross' certification of the same financial statements involved here was in violation of Rule 17a-5, 17 C.F.R. § 240.17a-5 and gave the customers a cause of action under section 18(a). *Rich* v. *Touche Ross & Co.*, 415 F.Supp. 95, 101-02 (S.D.N.Y. 1976). Judge Brieant dismissed the complaint, finding that since the plaintiffs did not meet the purchaser-seller requirements of 18(a) they stated no claim for the alleged violation of Rule 17a-5. Id. at 102-04.

The principle of statutory construction by which one reaches this result is somewhat forbiddingly known as *"expressio unius est exclusio alterius"*. This maxim was recently emphasized and applied by the Supreme Court in *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers,* 414 U.S. 453 (1974) (*Amtrak*). There the Court held that the plaintiff association of railroad passengers had no implied cause of action as primary beneficiaries of the Rail Passenger Service Act of 1970 since that Act expressly provided for enforcement by the Justice Department. In its opinion, the Court observed:

> A frequently stated principle of statutory construction is that when legislation expressly provides a particular remedy or remedies, courts should not expand the coverage of the statute to subsume other remedies. "When a statute limits a thing to be done in a particular mode, it includes the negative of any other mode.". . . This principle of statutory construction reflects an ancient maxim—*expressio unius est exclusio alterius.* Since the Act creates . . . a private cause of action only under very limited circumstances, this maxim would clearly compel the conclusion that the remedies created are the exclusive means to enforce the duties and obligations imposed by the Act.

414 U.S. at 458.

Soon after its decision in *Amtrak* the Supreme Court reaffirmed its reliance on the *expressio unius* principle in *Securities Investor Protection Corp.* v. *Barbour,* 421 U.S. 412, 418-19 (1975). In finding that the express statutory grant to the SEC of a right to seek injunctive relief to enforce duties under the Securities Investor Protection Act precluded an implied right in others to seek similar relief, the Court reiterated its observation in *Amtrak* that "express statutory provision for one form of proceeding ordinarily implies that no other means of enforcement was intended by the Legislature." Id. at 419.

Similarly, in the instant case the provision by Congress in section 18(a) of a narrow private cause of action for section 17(a) infractions militates strongly against our attributing to Congress a willingness to allow more expensive enforcement of the duties and obligations created by that section. Moreover, while the Court in *Amtrak* acknowledged that the *expressio unius* principle must "yield to clear contrary evidence of legislative intent," 414 U.S. at 458, the majority here concedes that it finds nothing in the language or legislative history of section 17(a) to indicate that Congress intended to create a private cause of action under that section. In my view appellants have failed to demonstrate the "clear contrary evidence" to rebut the conclusion that the limited express right of action under section 18(a) is the exclusive remedy for a breach of section 17(a).[4]

We find further support for the position that there is no private right of action implied under section 17(a) in *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975). There the Court commented: "When Congress wished to provide a remedy [under the '34 Act] to those who neither purchase nor sell securities, it had little

[4] I do not overlook Judge Timbers' recent opinion in *Abrahamson* v. *Fleschner*, 568 F.2d 862 (2d Cir. 1977), petition for cert. filed, 46 U.S.L.W. 3588 (U.S. March 21, 1978) (No. 77-1279), which the majority cites to distinguish *Amtrak* and *Barbour* on the ground that those cases did not involve implication of private actions under the securities acts. It is important to note that in *Abrahamson*, where the court found a private right of action for damages implied for violations of section 206 of the Investment Advisers Act, 15 U.S.C. §80b-6, Judge Timbers, in his opinion for the majority, repeatedly stressed that the Investment Advisers Act made *absolutely no provision* for express private actions. Id. at 872, 874, 875. The opinion in *Abrahamson* contrasts this omission to those other securities acts which contain "sections *expressly* granting injured parties a private action for damages." Id. at 874 (emphasis in original); see *Piper* v. *Chris-Craft Industries, Inc.*, *supra*, at 24-25. Indeed, in this connection the opinion then refers specifically to section 18 of the '34 Act. Id. at 874 n.20. Judge Timbers concluded: "Had Congress provided explicitly for private damage actions it would be unnecessary to consider whether the remedy should be judicially implied." Id. at 875. This conclusion in *Abrahamson* is in fact strongly supportive of the analysis in this dissent.

trouble in doing so expressly" 421 U.S. at 734. Judge Wyatt's opinion below reviews several such sections of the '34 Act which impose liability on persons other than purchasers or sellers. 428 F.Supp. at 490. The presence of these provisions in the '34 Act reinforces the conclusion that the framing of the section 18(a) remedy in terms of purchasers and sellers of securities to the exclusion of customers of broker-dealers was an intentional congressional limitation on the class for whom a private action would be available in the event of a section 17(a) violation.

The Supreme Court in *Blue Chip* also addressed itself specifically to section 18:

> Section 18 of the 1934 Act, prohibiting false or misleading statements in reports or other documents required to be filed by the 1934 Act, limits the express remedy provided for its violation to "any person . . . who . . . shall have purchased or sold a security at a price which was affected by such statement. . . . It would indeed be anomalous to impute to Congess an intention to expand the plaintiff class for a judicially implied cause of action beyond the bounds it delineated for comparable express causes of action.

421 U.S. at 736.

But that is precisely what the majority is imputing to Congress in this case. The misleading reports which create the basis for the claim here made were required to be filed by section 17(a) of the '34 Act and the remedy provided by section 18(a) concedely encompasses not broker-dealer customers but only securities purchasers or sellers.[5] I find that *Amtrak*, *Barbour* and *Blue Chip*

[5] It should be noted that in another suit arising out of the Weis debacle Judge Wyatt has sustained a section 18(a) claim asserted by a plaintiff bank which allegedly purchased securities of Weis in reliance on the section 17(a) reports involved in this case. *Exchange National Bank* v. *Touche Ross & Co.*, 75 Civ. 916 (S.D.N.Y.).

compel the conclusion that the omission was studied and that the implication of a damage action against accountants under this section is totally unwarranted. The majority cannot properly characterize this as a case where there is no explicit private remedy provided by Congress. Rather, it is a case in which the remedy provided was designed to exclude the class which is here seeking monetary relief. Thus, the majority's holding in my view goes beyond statutory construction; it amounts instead to judicial legislation.

II

The second flaw in the majority opinion is the failure to consider the impact of *Piper* v. *Chris-Craft Industries, Inc., supra,* in its discussion of the *Cort* factors. In *Piper* the Court, while again carefully limiting its holding to cases where the statute to be construed provides no private remedy, id. at 24-25, emphasized that private relief will be implied in favor of a particular class intended to be protected by the statute only when it is " 'necessary' " to effectuate Congress' goals. 430 U.S. at 25.[6] The inquiry called for is to ascertain the congressional purpose and to determine whether a private damage action by brokers' customers is a *necessary* adjunct, id., to accomplish the primary congressional goal embodied by the legislation. *Cort* v. *Ash, supra,* at 84.

The plain language of section 17 establishes the congressional concern that the SEC be kept on notice of the financial health and stability of registered broker-dealers through whom public investors purchase and sell securities.

[6]The underscoring of the element of necessity three times in the *Piper* opinion, 430 U.S. at 25, indicates the emphasis the Court wished to bring to this factor in determining whether a private remedy should be implied. *Piper,* therefore, is not simply a restatement or affirmation of *Cort* but adds a significant gloss. *Wilson* v. *First Houston Investment Corp.,* 556 F.2d 1235, 1239, 1240 (5th Cir. 1978).

The SEC itself has long recognized that the primary protection for brokers' customers lies in preventive monitoring: "customers do not open accounts with a broker relying on suit, judgment and execution to collect their claim—they are opened in the belief that a customer can, on reasonable demand, liquidate his cash or securities position." *Guy D. Marianette,* 11 SEC 967, 971 (1942). Hence, the broker-dealer is required to file reports which are subject to such examination as the SEC may deem necessary or appropriate in the public interest or for the protection of investors. As the majority points out, a principal and, in fact, dominant method of investor protection is the net capital rule. Section 15(c)(3) of the '34 Act, 15 U.S.C. § 78o(c)(3), authorizes the SEC to provide safeguards with respect to the financial responsibility of broker-dealers including their "acceptance of custody and use of customers' securities, and the carrying and use of customers' deposits or credit balances." Pursuant to Rule 15c(3)(1)(b)(2), 17 C.F.R. § 240.15c3-1(b)(2), the SEC exempts broker-dealers who are members in good standing of the New York Stock Exchange (as was Weis) from compliance with SEC net capital requirements. This is because such broker-dealers are subject to Exchange Rule 325, which is deemed by the Commission to impose requirements more comprehensive than the requirements of the SEC. Id. Under Rule 325 Weis was required to maintain a minimum prescribed ratio of aggregate indebtedness to net capital. Compliance by broker-dealers with the net capital rule is ensured by the filing of reports and monitoring by SEC as well as by the Exchange, which is authorized to enforce its regulations, see 15 U.S.C. § 78(f) and which, according to the SEC brief submitted on this appeal, makes annual examinations of each of its broker-dealer members to this end.

Congressional concern for the solvency of broker-dealers was not limited to the reporting and monitoring requirements of section 17. Following the boom of the

1960's a number of brokerage firms experienced financial instability and even failure. *Securities Investor Protection Corp.* v. *Barbour, supra,* at 415. The response of Congress was the enactment in 1970 of the Securities Investor Protection Act (SIPA), 15 U.S.C. §78aaa *et seq.* as an amendment to the '34 Act. Under SIPA Congress created the Securities Investor Protection Corporation (SIPC), the function of which extends well beyond providing protection to investors upon the liquidation of their brokers. As the Court noted in *Securities Investor Protection Corp.* v. *Barbour, supra,* at 421:

> The SIPC properly treats an application for the appointment of a receiver and liquidation of a brokerage firm as a last resort. It maintains an early-warning system and monitors the affairs of any firm that it is given reason to believe may be in danger of failure.

The SEC too has noted that the primary purpose of the net capital requirements for broker-dealers is to give "the [SEC], self-regulators and SIPC sufficient early warning to take appropriate action to protect customers prior to the time . . . of liquidation." 1934 Act Release No. 11497, June 26, 1975 [1975-76 Transfer Binder], CCH Fed. Sec. L. Rep. ¶80,212.

The majority here finds that since section 18(a) leaves broker-dealer customers without protection and since brokers' customers are the "favored wards" of section 17, it cannot agree that Congress simultaneously sought to protect them and to deprive the class of the means of protection. However, a review of section 17(a) and the rules promulgated by the SEC as well as the creation of SIPC, demonstrates that the means Congress employed to ensure solvency of broker-dealers were to require the keeping and filing of records, the maintenance of certain net capital balances and the oversight of

the SEC, SIPC and the Exchanges. Thus, the primary congressional intent obviously has been to provide a system of reports and monitoring which would *prevent* insolvency of broker-dealers; not to create private law suits for damages *after* insolvency has occurred.[7]

Since the filing requirements of section 17(a) are designed to give early warning, the importance to this scheme of implying a damage remedy *after* liquidation is dubious. Congress made no suggestion either in 1934 or in 1970, when it enacted SIPA, that a private damage action was a *necessary* corollary of the section 17(a) reporting provisions. The threat of liquidation under SIPA as well as the criminal sanctions available for violations of section 17(a) certainly present a greater deterrent than private damage actions.[8] As the Supreme Court noted in *Piper,* "Nor can we agree that an ever-present threat of damages [beyond available injunctive relief] . . . will provide significant additional protection. . . . The deterrent value, if any, of such awards can never be ascertained with precision." 430 U.S. at 39-40.

Even more importantly, to the extent that a threat of private damage actions might further induce compliance with the reporting scheme of section 17 the majority has discounted the effect of available state law remedies, which arise not from state securities law protection of brokers' customers, but from well established tort law

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[7]In fact SIPC's preventive measures have been quite successful. The vast majority of firms brought to SIPC's attention have been deterred from the necessity of undergoing a SIPC liquidation through a variety of tactics including mergers and withdrawal from the business of carrying customer accounts. See *Securities Investor Protection Corp.* v. *Barbour, supra,* at 421 n.4.

[8]For example, in the instant situation the SEC initiated an action for injunctive relief against Weis and its officers. *SEC* v. *Weis Securities, Inc.,* 73 Civ. 2332 (S.D.N.Y.). A number of Weis' principals were also convicted of a criminal conspiracy to falsify Weis' books of account. See *Rich* v. *Touche Ross & Co., supra,* 415 F.Supp. at 101.

principles.[9] See, e.g., Restatement 2d of Torts §§ 531,552 (1977). Common law actions for damages against accountants have long been recognized. See, e.g., Note, Accountants' Liabilities For False and Misleading Financial Statements, 67 Colum. L. Rev. 1437 (1967). Where, as in the instant case, fraud is arguably alleged, it is important to note that should the actionable elements of fraud be provable, the states have universally permitted recovery to third parties who relied on the misrepresentations. Anno.: Liability of Public Accountant to Third Parties, 46 A.L.R. 3d 979, 982-83 (1972). While the state law treatment of actions based only on an accountant's negligence has not been so uniform, id. at 982, the trend in state law, based on generally recognized tort principles, has been to expand the accountant's liability for negligence to those clearly definable classes of third parties who the accountant knew would rely on the statements in question. See, e.g., *White* v. *Guarente,* 43 N.Y.2d 356, 401 N.Y.S.2d 474 (1977); Restatements 2d of Torts § 552 (1977). In fact, should scienter be held a required element of the action found implied by the majority in section 17,[10] see *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976), it may well be that a state law action would provide a broader basis for accountant liability than the federal action implied here under the '34 Act.

In any event, the very existence of these state law remedies supplies that threat of liability which the majority essentially is seeking in order to promote adherence to the requirements under section 17(a).

[9]The same cannot be said of the appellants herein. In addition to the state law class action against Touche Ross which has been filed by Weis' customers in the Supreme Court of New York County, see *Rich v. Touche Ross & Co., supra,* 415 F.Supp. at 104, the appellants have initiated a state law action based on the same common law claims set forth in their complaint in this federal action. *Redington* v. *Touche Ross & Co.,* No. 13996/76 (Sup. Ct. N.Y. Co.).

[10]The point was reached neither by the majority here nor by Judge Wyatt below.

Thus, the majority wrongly dismisses the significance of availiable state law remedies on the ground that the standard of liability for private damage actions in connection with 17(a) violations must be national in scope. Since, as demonstrated above, the *primary* congressional purpose underlying the section 17 reporting scheme is prophylactic, uniformity of standards for actions brought to recover losses *after* the brokerage firm has failed simply is not *necessary* to achieving the primary goals of that statute. See *Santa Fe Industries, Inc.* v. *Green,* 430 U.S. 462, 477-78 (1977).

The SEC has also argued, and the majority has accepted the position, that private damage actions are a necessary supplement to commission action because the SEC does not have the resources to audit the financial statements submitted under section 17(a). Whatever force this argument might once have had, see *J. I. Case Co.* v. *Borak, supra,* 377 U.S. at 432, is seriously undermined by the Court's observation in *Piper* that "institutional limitations alone do not lead to the conclusion that any party . . . should have a cause of action for damages." 430 U.S. at 41. The argument that a regulatory agency is confessedly unable properly to regulate broker-dealers as charged by Congress and detailed by its own regulations, and that therefore the federal courts should find a damage remedy implicit in an act which studiously avoided giving one to the class sought to be represented here, is simply unpersuasive.[11]

In sum, I conclude that since section 18(a) of the Act does provide a damage remedy for the filing of misleading statements in section 17(a) reports, and since this remedy excludes from its coverage the customers of

[11]The problem faced by the SEC in *Borak* of examining proxy statements under demanding time limitations (10 days or even 2 days, 17 C.F.R. §§ 240.14a-6(a), (b)), as pointed out by Judge Wyatt, 428 F. Supp. at 491, is not encountered here. Moreover, the SEC itself has stated that its burdens in this connection are lightened by the Exchange, which makes annual examinations of net capital statements by its members.

broker-dealers, the *Cort* factors employed by the majority afford an inappropriate analytical framework for this case. Instead, under the reasoning of *Amtrak* and *Barbour* it is apparent that by limiting actions under section 18(a) to purchasers and sellers of securities Congress expressed its intent to deny recovery for section 17(a) violations to a broader class of plaintiffs. Nor have the appellants here adduced the strong contrary evidence of legislative intent regarding section 17(a) which would lead me to reach the conclusion, embraced by the majority, that implication of such a remedy is consistent with the legislative scheme. Moreover, even if the *Cort* factors were the proper mode of analysis in this case, they must be applied in conjunction with the gloss of *Piper*. Yet there is no showing here that a private damage remedy against accountants is *necessary* to vindicate the primary congressional purpose embodied in section 17(a). As Judge Medina observed in *Lank* v. *New York Stock Exchange*, 548 F.2d 61, 65 (2d Cir. 1977) where we refused to imply a private remedy in favor of the SIPC receiver of an insolvent broker-dealer against the Exchange: "Even were we to agree . . . that granting him a right of action against the Exchange would 'accord' with the purpose of the [1934] Act, our function here is to discern the intent of Congress, not to legislate in its place."

III

Having found no implied cause of action arising under section 17(a) in favor of customers of broker-dealers, I could of course find no derivative rights in either SIPC or the trustee. However, I also contest the holding that appellants are proper parties to maintain the action found by the majority to be implied in section 17(a). The majority has properly held that neither the trustee nor SIPC in its own right can bring any action under section 17(a) of the '34 Act. Neither can claim to be an intended beneficiary of that act since both are the

creatures of SIPA, enacted in 1970. Nor is either appellant a public investor. *Lank* v. *New York Stock Exchange, supra,* 548 F.2d at 64-66 is dispositive of this issue.

Yet while denying to SIPC the right to bring a section 17(a) action on its own behalf, the majority also transmutes that entity into a subrogee clothed with the power in that capacity to bring a private damage action under 17(a) (an action itself now implied by the majority for the first time in the forty-four years section 17 has been on the books). By what alchemy a congressionally created corporation with limited powers to litigate, see *Securities Investor Protection Corp.* v. *Barbour, supra,* can now sue in a federal court for an alleged violation of section 17(a) of the '34 Act, is not made clear. When Congress created SIPC, its express but limited rights of subrogation were spelled out in SIPA: "To the extent that moneys are advanced by SIPC to the trustee to pay the claims of customers, SIPC shall be subrogated to the claims of such customers with the rights and priorities provided in this section." 15 U.S.C. § 78fff(f)(1). As the majority recognizes, those claims to which SIPC is subrogated by statute are clearly against the debtor's estate only and no rights against the accountant flow therefrom. Since Congress has delineated the subrogation rights of SIPC, its failure to provide for subrogation against any third party would clearly dictate that none exist under the previously discussed principle: *expressio unius est exclusio alterius. Rogers* v. *National Surety Co.*, 116 Neb. 170, 216 N.W. 182 (1927). The effect of the majority's extension of SIPC's subrogation rights is to circumvent the intent of Congress by ignoring the directive of SIPA that SIPC be subrogated *"with the rights and priorities provided in this section."* 15 U.S.C. § 78fff(f)(1) (emphasis supplied).

Similarly, the Trustee, held by the majority to have no direct cause of action under section 17(a), is

nonetheless found to have such capacity in his role as a bailee. The majority finds that his responsibility to marshal and return property to the customers of the debtor broker-dealer authorizes him to bring this action. But that responsibility of the Trustee is created by SIPA, 15 U.S.C. § 78fff(a)(1), and is inherent in his Trustee function, see also 15 U.S.C. § 78fff(b)(1). Having rejected his right to sue as a Trustee of Weis under *Lank* v. *New York Stock Exchange, supra,* I fail to see how denominating him a bailee adds a jot or a tittle to his statutorily created status as the representative of Weis—an entity regulated by, and precluded from suing under, the Act. Furthermore, the customers on whose behalf the Trustee seeks to maintain suit are not only entitled to bring, but have already initiated their own action against Touche Ross. See notes, 3, 9, *supra.* The SEC understandably has expressed no view on this point.

For these reasons I respectfully dissent and would affirm Judge Wyatt's decision below.

Judgment of the Court of Appeals

United States Court of Appeals

FOR THE

SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit held at the United States Courthouse in the City of New York, on the twenty-first day of April one thousand nine hundred and seventy-eight.

Present:

HON. J. EDWARD LUMBARD
HON. WILLIAM H. MULLIGAN
HON. WILLIAM H. TIMBERS

Circuit Judges,

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,
Plaintiffs-Appellants,

v.

TOUCHE ROSS & Co.,
Defendant-Appellee.

77-7183

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is reversed and the action be and it hereby is remanded to said district court for further proceedings in accordance with the opinion of this court with costs to be taxed against the appellee.

A. DANIEL FUSARO,
Clerk

By ARTHUR HELLER,
Deputy Clerk

Order Denying Petition For Rehearing

United States Court of Appeals

SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the seventh day of July, one thousand nine hundred and seventy-eight.

Present:

HON. J. EDWARD LUMBARD
HON. WILLIAM H. MULLIGAN
HON. WILLIAM H. TIMBERS

Circuit Judges.

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,
Plaintiffs-Appellants,

vs.

TOUCHE ROSS & Co.,
Defendant-Appellee.

Docket No. 77-7183

A petition for a rehearing having been filed herein by counsel for the appellee, Touche Ross & Co.

Upon consideration thereof, it is Ordered that said petition be and it hereby is DENIED

A. DANIEL FUSARO,
Clerk

Order Denying Rehearing En Banc

United States Court of Appeals

SECOND CIRCUIT

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the seventh day of July, one thousand nine hundred and seventy-eight.

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION, *Plaintiffs-Appellants,* v. TOUCHE ROSS & CO., *Defendant-Appellee.*	Docket No. 77-7183

A petition for rehearing containing a suggestion that the action be reheard en banc having been filed herein by counsel for the appellee, Touche Ross & Co., and no active judge or judge who was a member of the panel having requested that a vote be taken on said suggestion.

Upon consideration thereof, it is Ordered that said petition be and it hereby is DENIED.

IRVING R. KAUFMAN
Irving R. Kaufman,
Chief Judge